INTRODUCTION

This volume contains a number of commentaries addressing a range of business and legal issues which, from our experience, are of interest to entrepreneurs and executives in the information technology industry. The discussions topics cover business and organizational matters, e-commerce matters, intellectual property and general securities law information. The following is a list of those people who have contributed material for this executive briefing guide and their contact information.

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PARTNERING
Negotiating and Structuring the Relationship to Manage Risk

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Partnering as a business concept is the contractual relationship between two or more business entities to achieve a mutually acceptable goal. For clarity, partnering relationships are not legal partnerships jointly carrying on a common business. There is no common business in a partnering relationship. Each of the parties, as far as the world is concerned, operates their own businesses independently of the other.

Common types of Partnering relationships include the development of technology or products, joint marketing, teaming arrangements and out-sourcing operations.

Partnering relationships are strategic to at least one of the parties. A common difficulty in such a relationship is with the risk of failure associated with the changes in technology and markets. If no vehicle is provided for management of and change of the relationship the potential for failure and dispute increases. The following is intended as guideline.

THE PROCESS

The negotiation of any contractual relationship is always predicated on the purpose. This is particularly true of partnering relationships where the complexity of the deal may permit the purpose to be lost among the details. During the course of negotiation – which can extend over many months – it is crucial to keep the purpose in mind and not to be consumed with "tactical" victories.

Typical partnering purposes include:

Efficiency/ Focus on Core Business

Efficiencies and a focus on core business are two sides of the same coin. By downloading required business functions that are not part of the core business, a business may streamline its efforts and focus on its core competencies while minimizing waste effort on matters that are the core competencies of other businesses. An example of downloading business functions is to turn over all matters relating to staffing including hiring, firing, and management, to a staffing business. Doing so permits a business to avoid not only the management distractions associated with management of staff but also to avoid the costs and risks associated with work that expands and contracts with the business' requirements, such as assembly type tasks.

Leverage

Leverage in Partnering Purposes may be financial but is more commonly technological, operations or marketing. Leverage is the use of a relationship to achieve a result that could not otherwise be obtained, or at least not at prohibitive costs. Leverage is distinguished from efficiency business purposes in that leverage may be in respect of core competency of the business and it is not something that can be achieved in the normal course of business. It is driven not by the desire to incrementally decrease cost, but rather is a leap into something otherwise not achievable. An example of leverage of technology is a joint development with a technology business in order to gain access to and an understanding of the technology. Without the joint development, acquisition of skill sets to understand the technology may be prohibitively costly or even impossible. Marketing partnering relationships are a very common way to leverage complementary products and technologies to deliver solutions and product suites.

RISK

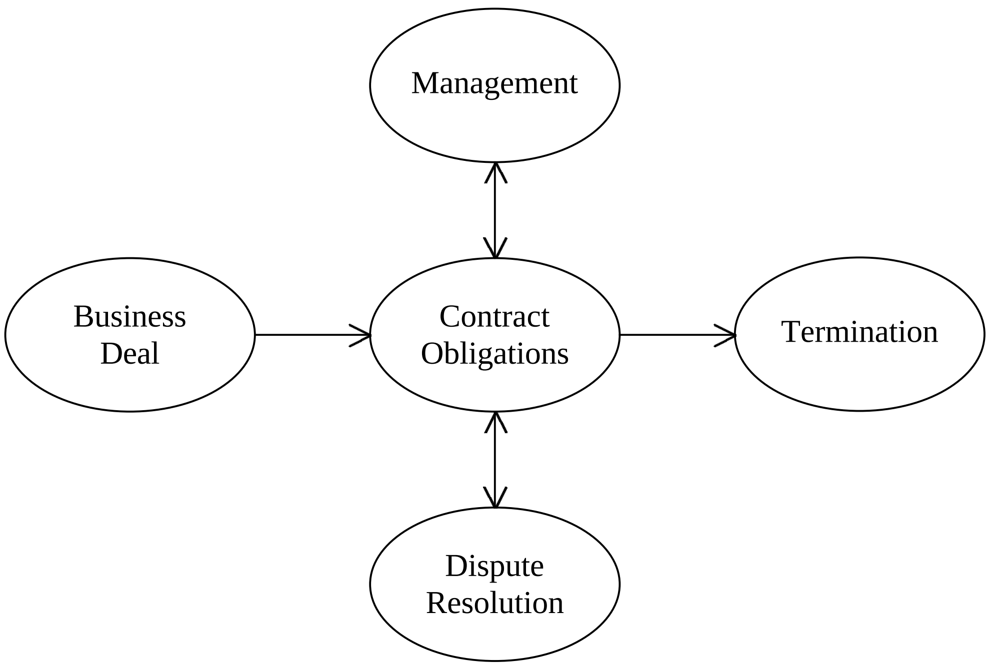
Risk is inherent in any transaction. Is this any different in Partnering relationships? The answer is emphatically yes. Consider an ordinary commercial relationship for the supply of a good. All terms of the contract are known and specified in the contract. The price, delivery terms, quantity and quality of goods, and payment and all other terms are agreed to. There is still risk. The supplier could fail to deliver; the buyer could refuse to pay etc. However these risks can largely be assessed at the beginning and the remedies prescribed. If there is an unacceptable risk of non-payment, the contract will provide for a security interest to secure payment. If there is an unacceptable risk of delay of delivery, the contract will provide for liquidated damages. In short, the risks are known and either accepted or dealt with in the negotiations and the contract. This is not to say that external factors are not risks. The market demand for product could disappear overnight leaving you with an inventory of excess products and an agreement providing for the supply of additional excess products. However these risks are part of the ordinary risks of doing business and do not affect ordinary contractual relationships.

The risks in Partnering relationships include all the same risks as ordinary contractual agreements, but import a further risk due to external factors. Consider an outsourced manufacturing relationship in which all of the manufacturing processes usually completed internally are turned over to a third party. The contract cannot specify a fixed supply of product because the market demand cannot be known with certainty in advance. How is the risk of over or under supply allocated between the parties? How does pricing account for short or long production runs when the length of the runs is not known? The specifications of the product itself will likely change over the duration of the relationship (and in technology businesses this is a certainty). How is pricing adjusted to reflect the change of costs including fixed and non-recurring expenses? How does the contract deal with changes in prices to inputs – labour and components?

There is a direct correlation between assumption and risk and price. A greater assumption of risk requires a greater return to compensate. The identification of the risk, how that risk is managed and how the risk is borne by parties is a large part of what the contract for the partnering relationship is all about.

STRUCTURE

The Agreement for a Partnering will differ from an ordinary commercial agreement both quantitatively (it tends to be more complex) but also qualitatively. The following is a visual representation of the basic elements that constitute a partnering relationship and which are distilled into the contractual agreement.



Business Deal

The Business Deal is the framework over which the contractual agreement is built. The Business Deal usually is achieved at high level and deals with high level concepts. The Business Deal is usually based on a set of mutually agreed assumptions upon which the basic obligations of the parties can be outlined. The Business Deal often addresses the risk of variances from the agreed assumptions superficially, if at all.

Contract Obligations

Contract obligations in this context are those obligations and rights, which relate to the business deal (as opposed to management, dispute resolution and termination which are reviewed separately. As with other ordinary contracts, there are risks related to usual contractual terms. In addition, there are risks in a partnering relationship that occur as a result of the closeness of the relationship and blurring of the separate corporate identity.

Ownership of intellectual property rights ("IP") that result from a partnering relationship is a common issue, particularly if there is a joint development where each of the parties brings their skill sets and proprietary IP to the table. A facile solution sometimes adopted is joint ownership. Unfortunately joint ownership itself has difficulties attached to it. For example, may a joint owner of patent rights unilaterally register a patent application without the consent of the co-owner? What about the right to pursue infringers, must both owners join the action? How about the right to further sub-license? What rights to are there to the other party' IP which was not created in the partnering relationship but it necessary for the use of the jointly created IP. Are both parties liable for infringement for either party's use of the IP? What indemnities are given against infringement? What indemnities are given against third party claims?

A partnering agreement should provide for mechanisms for the identification of the IP contributed to or used in the relationship to avoid disputes over the ownership of pre-existing rights. The partnering agreement must provide for who takes ownership of newly created IP and what license rights the parties have to the new IP, as well as to existing IP. If there is joint ownership, the rights and obligations of the parties as joint owners must be set out in some detail to include: restrictions on markets and use, rights to license and sublicense, rights to register, rights and obligations to pursue infringement and indemnities on infringement.

A partnering relationship will invariably involve some disclosure of information of a proprietary or confidential nature. The agreement must provide for the identification of what information is impressed with an obligation of confidentiality, and how this information may be used by the receiving party both during and after the termination of the relationship. This issue is particularly important where there is an imbalance of risk from the use of the other's confidential information.

Management

The extent to which the relationship is managed is a key feature, which differentiates a Partnering relationship from an ordinary contract. Management is necessary because all of the possible external events which have an affect on the partnering relationship cannot be fully explored and dealt with in the agreement. There must be a mechanism for the parties to manage the effects of these events. Effective management requires access to the right information by right people, and with the ability of those people to affect outcomes.

Information

Information is required in order to understand what the range of potential outcomes are, if those outcomes may be influenced, and how to influence is most effectively asserted to achieve the desired outcomes. Partnering demands consideration of qualitative (the quality or type of information) and quantitative (the quantity and frequency of the disclosure of the information) information requirements.

The contract is the vehicle by which the information needs are met. The contract must explicitly provide in both general and specific terms the quality and quantity of information required. The specific terms define the minimum expectation for the delivery of information. The general provisions allow for the demand of other information not specifically mandated by the agreement. It is simply not sufficient to provide for the general requirements and “work out” the specifics at a later date or assume that the level of exchange of information which pervades during the negotiation will continue.

The reverse side of obtaining information from the other party is that you will also be obliged to disclose information. Consideration as to what may be disclosed and what should not be disclosed must be identified. While the contract will usually provide for restrictions on the use of information disclosed, such restrictions may not be sufficient for particularly sensitive information.

Delivery

Information is useless unless the right people obtain the right information in a timely manner. There is no model for how the flow of information must be managed to maximize the achievement of desirable results. Even within an organization, information flows don’t necessarily follow a chain of command and indeed, distributed information flows can be much more effective. However the bottom line on most partnering arrangements is that although the organizations may be allies today, they may be competitors tomorrow. There are consequences, including substantive legal ones, which result from decisions made and actions taken in a partnering relationship. This generally means that:

> (a) information flows must be identified and flowed through channels. Information of a technical nature will generally flow through technical managers and information of a financial nature will flow through financial managers. Some information will be of a hybrid nature and will flow through both channels.
>
> (b) Information which is proprietary and secret must be identified as such. It is not sufficient to assume that everything that you provide is proprietary and secret – it is not. If your information is misused, it is a matter of evidence whether or not it was disclosed under obligations of confidentiality or secrecy. If it is clearly identified as secret – it is hard for the receiving party to assert otherwise. Similarly, the maintenance of logs which record what confidential information is disclosed, to whom and when creates the evidentiary trail.

Affect Outcomes

Management within an organization works usually on the twin basis of authority and responsibility. The ability of an individual within the organization to make decisions depends on the level of authority granted to that individual, and the responsibility of that individual to achieve the outcome. The separate corporate nature of each of the parties to a partnering relationship breaks apart the authority of one party from the responsibility of the other. For example, in an outsourced manufacturing agreement, the quality control officer of the purchasing organization charged with the responsibility to ensure standards are met has no authority over those persons in the other organization who are in control of production.

A contract for a partnering relationship must address the discontinuity between responsibility and authority in a way that respects the separate corporate nature of the parties but permits outcomes to be appropriately managed. This is achieved by identifying those matters which one party requires the authority to affect the outcome but the other party has the responsibility of performance, and by further determining the range of decisions. For example, in a partnering relationship formed for marketing purposes, one of the parties may have the responsibility for preparing and issuing advertising materials which includes the branding etc of the second party in accordance with the specifications of the agreement. The second party may wish to have authority to affect the final copy, notwithstanding the responsibility of the first party for its production. The authority of the second party may be absolute – that without its approval the copy is not issued, or something lesser such as the right to comment only on particular aspects.

Dispute Reconciliation

Most complex commercial agreements provide for some mechanism of dispute resolution. In most cases, these mechanisms simply substitute mediation or arbitration or both for the Courts. Some mechanisms do not go far enough.

Escalation Procedures

Escalation procedures useful to prevent small disputes from escalating into major disputes. Escalation procedures are mechanisms which permit disputes to be addressed at relatively low levels in the organization and involve the people directly affected. The process is less formal, often does not involve legal advisors and tends to be much less adversarial. Disputes tend to be resolved earlier and with less damage to the participants and the relationship.

Mechanisms

Many alternative dispute reconciliation mechanisms fail in their intent to provide a quicker and less expensive process with "better" results than use of the Courts. A principal reason for this is that the process is not sufficiently addressed in the agreement. Parties which genuinely consider it their mutual best interests will make the dispute reconciliation work – because it is in their best interest to do so. If one party does not consider it in its best interest to cooperate, a simple dispute reconciliation provision is rife with opportunity to delay and disrupt the process, and to considerably increase the cost. Matters that are often subject to dispute include the selection of the arbitrator, the rules regarding admittance of evidence, use of experts, forum, applicable laws and the like.

These risk of dispute over the alternative dispute reconciliation mechanisms are resolved either by reference to a set of rules published by an arbitral association or by well drafted provisions that set forth in considerable detail the rules of that the parties agree to follow. Well drafted rules are usually preferable because the parties have actually considered every provision and reached agreement – however such provisions are themselves complex and negotiating such provisions may exhaust the parties. Reference to the rules published by an arbitral association is an acceptable way to specify the process for the alternative dispute reconciliation mechanisms.

The dispute reconciliation provisions must address the legitimate concerns of the parties but at the same time, the provisions must not be such that there is a built-in incentive to use the provisions rather than attempting to resolve the dispute directly with the other party. For example, if there is a dispute provision that permits a party to dispute the calculation of royalties payable, and that regardless of the results the costs of the mediator/arbitrator are equally shared, the party asserting the dispute has little to lose in asserting the dispute. If the arbitration is structured for costs to be paid by the asserting the dispute, and only paid by the other party if it is determined that the royalties are understated by x%, then there is a “cost” to asserting the dispute.

The dispute reconciliation mechanisms can also be defined so as to establish the range of possible results in order to avoid either an absurd result, or to avoid rewarding a party for taking an extreme position. For example, the agreement may provide that the arbitrator may only be permitted to award the offer of party or the other rather than a “compromise position”. Clearly such a provision is likely to work only where there are fairly narrow ranges for the dispute.

Termination

Partnering relationships may be indefinite in term or they may be fixed in duration. Termination is not “boilerplate” issue that is left to the lawyers. It is a substantive term in itself, the implications of which must be considered at the outset.

Termination is divided between events that give rise to the termination, and the consequences which follow. Consideration of the events that give rise to the termination go beyond those normally found in ordinary contracts. Consider a partnering relationship the purpose of which is to strategically position your organization in the marketplace to obtain a competitive advantage. An acquisition by one of your competitors of a significant interest in the other party to the partnering relationship may significantly affect your strategic positioning and accordingly you may need to have the right to terminate. There are numerous other events for which termination may be desired in any partnering relationship, which are in additional to the usual boilerplate termination provisions.

Consideration must also be given to determining those matters within the agreement for which termination is excluded and for which other dispute reconciliation mechanisms are provided. For example, the change of specifications for an out-sourced manufacturing agreement will alter pricing. If the parties cannot agree on the new pricing, termination is a result unless pricing is excluded from termination and a process for determining pricing is provided for. There must be no gaps in the agreement that permits a party to circumvent an agreed on process for resolving disputes on specific items.

The consequences on termination are often much more complex in a partnering relationship. In some cases, the events that follow on termination will be determined by the reason for the termination. For example, a termination of a partnering relationship for the development of a new technology may provide for the rights of ownership and use to vest in a party if the other party to the relationship terminates the agreement because it is abandoning that marketplace. In other cases it is simply the event itself that should determine the consequences.

Partnering relations are often complex and the process for dis-entangling the relationship must be addressed to avoid additional disputes on the termination (when tension and volatility is already high). Dis-entanglement includes the identification and return of corporate assets, addressing incomplete items on termination (such as joint proposals that cannot be revoked or production lines that cannot be stopped), provisions for the “hand-over” to the other party or its new “partner” (crucial for outsourcing business functions such as accounting or staffing).

There usually are provisions in a partnering relationship that must survive the termination of the agreement. Such provisions include the obvious, such as the obligation to maintain as confidential the information of the other party. There may be other provisions which will survive termination in order to protect the rights agreed on in the agreement, such as the rights with respect to new technology created and licenses to the other’s technology. Finally there may be provisions newly created on termination, such as agreements not to compete in the other’s markets for a period of time following termination.

CREATING AND PROMOTING AN INTERNET PRESENCE

Website and E-Commerce Rules of Engagement

CREATING AND PROMOTING AN INTERNET PRESENCE
Website and E-Commerce Rules of Engagement

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INTRODUCTION

Canadian law embodies a fairly comprehensive set of domestic rules pertaining to advertising, commercial and consumer transactions, and general contracting issues. Organizations are expected to abide by such rules in the conduct of their normal business operations. Sometimes such rules are modified through international treaties, trade agreements, and agreed-to standards. In these instances, domestic rules every now and then give way to prevailing international provisions or to those of other countries. Sometimes, by way of example, the prevailing law governing a business relationship between parties may not be the one specified in the contract, but rather that of another jurisdiction. In the pre-Internet days, organizations generally became accustomed to transacting business in foreign countries through investigating and adhering to the laws of the state or country in which such business was transacted. However, this has all changed with the universality of the Internet! Organizations desiring to establish an Internet presence, in particular those that propose a multi-jurisdictional presence that may include activities outside of Canada, must expand their macro knowledge base of legal issues. There are a variety of international, cross cultural and jurisdictional repercussions, many of which are of a less obvious or hidden nature. Such organizations must develop and implement protocols and procedures that will allow effective operations without violation of the laws of the foreign or home jurisdictions.

Unfortunately, neither time nor space permits a treatise on the laws of the Internet. This paper will briefly deal with selected matters relevant to the creation of an Internet presence. Specifically, the paper will review issues of compliance with laws applicable to the following activities: advertising, promotions, contests and draws, and the use of disclaimers. In addition, the paper will give consideration to selected intellectual property law issues, privacy law developments, and relevant international agreements.

As this paper comments on certain elements of Canadian law only, it should be read with caution. Activity that is contrary to Canadian law could be perfectly legal in other jurisdictions and vice versa.

ADVERTISING AND PROMOTIONS

Internet Advertising

Advertising on the Internet introduces new legal risks. Specifically, on-line content can be accessed worldwide, so there is potential for international or multi-jurisdictional liability. To avoid offending foreign persons or governments, advertising content must be assessed for compliance.

It is important to understand that the nature of Internet advertising is much different than traditional advertising. Internet advertising is not broadcast or directed to the public at large, but instead is available to anyone who chooses to view it. It is not "pushed" upon people, instead a user "pulls" the information from the server on which it is held. Some commentators have argued that because of the pull nature of Internet advertising, there should be a lesser requirement for regulation. However, with the advent of "push technologies" (e.g. Pointcast, BackWeb and widely distributed, personalized Email), this argument becomes somewhat less tenable. There are many forms of advertising and marketing on the Internet. The following vehicles are used to carry Internet advertising:

(a) websites
(b) banner advertising
(c) cyber malls
(d) private networks
(e) electronic bulletin boards
(f) search engines
(g) browser programs
(h) direct email
(i) sponsorship and advertorials.

There is a great deal of concern about the potential for deception and fraud by unscrupulous Internet advertisers and web merchants. To date, in Canada, there has been little regulation or private litigation involving Internet advertising. However, before breathing any sigh of relief, it is to be noted that the Competition Bureau has successfully prosecuted one company in connection with a multi-level marketing scheme advertised on the Internet.[1] Also, the Bureau has begun to monitor Internet advertising.[2]

Application of Advertising Law to the Internet

In Canada, it is necessary for Internet advertisers to comply with prohibitions against false or misleading advertising contained in the federal food and drug, consumer packaging and labelling, hazardous product, textiles labelling and the competition legislation. At the provincial level, prohibitions are found in business practices and consumer protection legislation. This paper deals with the most relevant statutes respecting advertising: the *Competition Act*[3] and the *Ontario Business Practices Act*[4].

Recent Changes to Competition Law

In March of 1999, the *Competition Act* was amended with the passing of Bill C-20 (SC 1999, c.2). The criminal advertising and marketing practices provisions, previously contained in sections 52 to 59 of the Act were repealed and substantially repeated as reviewable conduct in sections 74.01 to 74.08 of the amended Act. The amendments, in effect, "decriminalize" the deceptive marketing practices sections of the Act.

The Act now classifies as "reviewable matters", false or misleading representations, warranties and ordinary price claims (formerly section 52 of the Act, now 74.01), reasonable tests and testimonials (formerly section 53 of the Act, now 74.02), bargain price and bait-and-switch selling (formerly section 57, 74.04), sales above advertised price, (formerly section 58, now 74.05), and promotional contests (formerly section 59, now 74.06).[5]

The new reviewable conduct regime provides the Competition Tribunal or the Federal Court a number of possible remedies:

(a) final cease-and-desist orders;
(b) interim cease-and-desist orders[6];
(c) orders requiring advertisers to publish corrective notices
(d) orders requiring advertisers to pay an "administrative monetary penalty"[7], of up to $200,000.

It is suggested, that the Competition Bureau decriminalized sections 52-59 of the old Act in order to make it easier to apply the Act to misconduct.

Deceptive and Unfair Trade Practices

Many provinces have statutory regimes to protect consumers. In Ontario, the *Business Practices Act* was enacted for this purpose. Essentially, an unfair trade practice is a representation or conduct that has the effect of being misleading or deceptive to the consumer.

The *Act* provides a number of examples of unfair trade practices including: representations that the goods or services have sponsorship, approval, performance characteristics, accessories, uses, ingredients, benefits or quantities they do not have; a representation that goods are of a particular standard, quality, if they are not; a representation that a specific price advantage exists, if it does not; a representation that the proposed transaction involves or does not involve rights, remedies or obligations if the representation is false or misleading; a representation using exaggeration, innuendo or ambiguity as to material fact, a representation failing to state a material fact; or a representation that misrepresents the purpose or intent of any solicitation of or any communication with the consumer.

Potential liability under these statutes should be considered carefully, because it is very likely that an advertiser's product or service will be closely examined by at least one competitor or consumer.

Disclaimers & "Legal Pages"

A disclaimer would be used to clarify a representation that in its absence would be false or misleading under the law. Many Internet advertisements contain lengthy disclaimers which are integrated into the information communicated. Typically, disclaimers contain copyright and trademark notices which are represented as required reading before a user can move on to the substantive information contained on the Web-Site.

A Legal Page sets out the terms and conditions that apply to the use of a Web-site. Legal Pages also stipulate the rights and limitations associated with a site. For instance, advertisers may wish to include disclaimers regarding the accuracy of information posted on the site; limitations of warranties and liability; warnings about use or misuse of proprietary information found on the Web-Site; disclaimers with respect to defamatory language; limitations on the re-use of downloaded software and lastly, restrictions or qualifications that apply to the claims or information presented by the advertiser. A Web-Site that offers links to other sites should include on its Legal Page, disclaimers with respect to the appropriation of rights associated with the linked site, as well as a disclaimer of any liability for statements contained on a linked site.

Under Canadian law, a disclaimer that substantially alters the primary message in an advertisement will not be effective in saving the advertisement from being found to convey false or misleading information. For example, an advertisement that claims that a product is free with a disclaimer indicating that a price must be paid.[8] Disclaimers that are prominent, rather than in the fine print, are more likely to be effective in avoiding liability for misleading advertising. Furthermore, the more sophisticated an audience for advertisement is, the more effective the disclaimer is likely to be in avoiding liability.[9]

Contests And Draws

One of the most popular devices used by Internet advertisers to attract interest is the sweepstakes or contest promotion. A contest on the Internet must comply with the laws of the jurisdiction of the promoter and the contestants. In Canada, Internet contests must comply with the legality of games provisions in the *Criminal Code*, and the disclosure requirements of the *Competition Act*.

Section 2.06 of the Criminal Code

Under the *Criminal Code* it is illegal for anyone other than a licensed lottery operator to award prizes by pure chance[10]. For this reason, contests usually include a skill-testing question to introduce an element of skill. In addition, games are illegal if participants "pay money or other valuable consideration" to play. Thus, contests usually provide in their rules a guarantee that "no purchase is necessary." However, if the word "consideration" is interpreted broadly, that guarantee may not be enough to avoid criminal liability. In the US, the courts have held that "consideration" may include the requirement of the participant to perform some act.[11] So, the filling out of a questionnaire might be "consideration". A contest sponsor should try to minimize the actions required to participate. Another problem specific to Internet contests is that access to the Internet itself may not be free of charge. Fees paid to service providers for access to a contest site could constitute money paid, attracting liability under the *Criminal Code*.

Section 74.06 of the **Competition Act**

This section requires that a contest promoter must disclose the number and value of the prizes, and the chances of winning the contest. It would be prudent for a contest promoter to make this disclosure as conspicuous as possible. Furthermore, potential entrants should be advised of the subject of disclosure requirements as early in the contest process as possible. i.e. a “Legal Page” that makes all the necessary disclosures and lists the rules of the contest. The Act also requires that the distribution of prizes must not be unduly delayed, and that the selection of participants or prize winners must be made on the basis of skill or by random draw.

The *Criminal Code* can apply to third party Internet service suppliers such as host providers and access providers. Those who knowingly provide hosting services to an promoter of an illegal contest could be liable under s.206(1)(a) of the *Criminal Code*. An access provider who knows that its service is being used to provide access to an illegal site could be liable under s.206(1)(c).

Quebec

A contest conducted in Quebec must comply with the provincial legislation governing contests[12]. This legislation requires: 1.) that a fee be paid to the province by the promoter, based on the value of the prizes offered to Quebec participants, 2.) a form be filed that includes the contest regulations and associated advertising, and 3.) if the contest promoter does not have a place of business in Quebec, security must be posted. Lastly, a contest in Quebec must also comply with the language laws of that province.

RELEVANT INTELLECTUAL PROPERTY LAWS

The Internet provides intellectual property owners with a vast market for their works. However, at the same time, the ease of copying, distributing and downloading information over the Internet makes large-scale violations of intellectual property rights more probable. Although there is no Canadian legislation directed at governing intellectual property interests on the Internet, general intellectual property principles and law are applicable. Not-for-Profit organizations who intend to develop an Internet presence should be knowledgeable about some of the following legal issues.

Copyright Law

Copyright law applies to work found on the Internet[13]. However, this paper will focus on special issues relating to the establishment of an Internet presence.

Implied License

Owners of copyright who place their work on the Internet may be taken to have given consent for others to make normal use of that material. This is referred to as an "implied license". For example, the posting of a message on the Internet implies an intention that the message will be reproduced and distributed by the system operator, or that it will be downloaded by users to be read. By posting something, the individual is in effect giving a license to others to make copies at least for the purpose of downloading. The scope of the implied license can be limited by agreement or by or express notice given to users. If no limits are expressed by the copyright holder, it has been suggested that users have those rights which represent the "natural and reasonable uses of the information on the site."[14] This kind of use may include the browsing of material.[15] However, the rights of the user should not extend to corporate or commercial use of the material.[16]

There is another type of consent that is given by placing a work on the Internet. Such placement makes that material publicly available, unless measures are taken to restrict access. That means users are entitled to use such materials under certain exemptions granted by copyright law, such as private study or educational use.

It would be prudent for organizations who place material on the Internet to clearly state ownership of their copyright on their web pages. They should also state that the use of any material which is subject to copyright is prohibited, except use which they may permit. Although copyright registration is not necessarily required for the protection of one's proprietary interest, it expands the scope of rights that may be exercised by the owner: registration provides evidence of the validity of the copyright ; it provides proof of first authorship or creation[17].

Web-Site Development

In the first instance, the designer of a Web-Site has the sole right to reproduce, publish, or communicate its work[18]. These rights can be assigned to another. The designer of a work also has the right to prevent uses of the work that may adversely affect the author's reputation, even after the sale or assignment of copyright. These are moral rights which can be waived by the designer. Anyone employing a designer to develop a Web-Site should obtain a clear assignment of the copyright, and a waiver of moral rights. A Web-Site development agreement is an essential tool for this purpose. A Web-Site agreement deals generally, with ownership of the Site as well as specific development and content issues. Specific development issues include functional and performance specifications, delivery timetables, acceptance testing, and project management. Specific content issues include, editorial approval, production credit and moral rights. Attached as Schedule "A" is a listing of some of the typical ownership clauses found in a Web-Site Development Agreement.

Trademarks

General trademark law applies directly to the Internet[19]. However, this paper will only deal with the special issues of domain names and hyperlinks.

Domain Names

What are they?

Actual Internet addresses are composed of four groups of numbers separated by decimals, known as the IP address. The domain name system was developed by the Internet Assigned Numbers Authority (IANA) to make it easier to remember Internet addresses.

In the domain name system, an Internet address is described by the URL, or Uniform Resource Locator. The URL is usually a combination of letters and punctuation which can be broken down into a number of levels and sublevels. A top level domain is generally of two types: geographic or generic. (ex. ".ca" or ".com"). A second level domain often includes a name. (ex. "langmichener".)

The most popular top level names for business in Canada are ".com", ".edu", ".org", ".net" and ".ca". The ".ca" domain is managed by the CA Domain Committee (CADC). The ".com" domain is managed by InterNIC, and ".edu", ".org", and ".net" are managed by Network Solutions Inc. (NSI)[20]. These registrars allocate domain names to applicants on a "first-come-first-serve" basis.

Legal Treatment of Domain Names

In the domain name system, no two sites can have the same address. Each domain name must be unique and is therefore associable with only one entity. Since most elements of the URL are generic, it is the second level or "name" domain that makes the URL a unique identifier of an organization. Thus, a domain name is analogous to a trademark as a "source identifier" for the advertisers' goods or services, depending on the extent to which it is used in widely disseminated advertising.

Trademark law allows more than one person to use the same name or mark as long as they are used for different products or services and create no likelihood of confusion. Thus, while two or more entities may have the right to use the same name as a trademark, they will not have exclusive right to use the trademark as part of their respective Internet addresses. The potential for a dispute over exclusive rights to a domain name containing a trademark is obvious. This problem is made worse by the fact that trademark registration can occur in more than one jurisdiction. These disputes must be resolved according to the general trademark law in each jurisdiction, and in accordance with the domain name dispute policy implemented by the relevant registration body.

Dispute Policies of CADC & NSI

Generally, these policies place the onus on the applicant to prove its entitlement to use the domain name. Neither the CADC, nor the NSI will intervene in a dispute concerning a domain name.

CADC

The CADC policy states: “It is your responsibility to ensure that you have the right to use the name you have chosen. Registering a domain name does not confer any legal right to that name; you should consider registering your trademark if you have not already done so. Any disputes between the parties over the right to use a particular name are to be settled between the contending parties using normal legal methods.”

NSI

The NSI policy requires rejection of domain names that contain obvious or well known names or trademarks. The policy also requires that applicants show that the proposed domain name does not infringe on any trade mark rights. An application can be challenged if there is a valid trademark. If there is a dispute, NSI will hold an application until is resolved. It should be noted that NSI domain names are subject to US legal principles, even if the applicant is a Canadian and does not carry on business in the US.

Trademark Law as it Applies to Domain Names

The use of a domain name which is the same as a recognized trademark of another, may constitute trademark infringement or the common law tort of passing off.[21]

In Canada, domain names were the subject of litigation in PEINET Inc. v. O’Brien. [22] The plaintiff’s Internet service provider issued them the domain name “PEINET.pe.ca.”. The plaintiff sought to prevent O’Brien, a former employee, from using the domain name “PEI.NET”, alleging that is was confusingly similar to its own name. The Provincial Supreme Court rejected the plaintiff’s motion because O’Brien used upper case letters and separated PEI from NET with a period. In ITV Technologies v. WIC Television Ltd.[23], the court refused to grant the Canadian holder of the “ITV.ca” domain name an injunction against another Canadian company using “itv.net”, even though the plaintiff had a long standing registration for “ITV”. The court’s rationale was that the defendant’s site contained an express notice that it was not affiliated with the plaintiff, and that the plaintiff had waited two year’s before bringing its injunction application.

These preliminary cases suggest that it is possible to register a domain name in Canada, similar to one that already exists, as long as the domain name is not exactly the same. A non-affiliation notice would also be prudent.

Cyber-Squatting

A cybersquatter is someone who purchases a domain name with the intention of selling it for profit, either to the bona fide owner of it, or to the highest bidder. In most cases, the cybersquatter uses the domain name in some minimal way to comply with the usage requirements of trademark law. (e.g. a “welcome” web page with little information of any utility.) The most common remedy is for the court to order the squatter to transfer the domain name to the plaintiff trademark owners. In a recent Canadian case, the Globe and Mail newspaper and Chapters Inc. bookstores announced a joint venture which would appear on the web site “www.chaptersglobe.com”, which had been registered. On the day of the announcement, an opportunist registered the domain name "chapter-globe.com" and publicized it. This person then offered to transfer the domain name to the joint venture, in return for a percentage of future Internet book sales. The court awarded the Globe and Chapters an interim injunction, preventing the individual from using his "chapter-globe.com" domain name. The court found that the registration had confused potential buyers, contrary to Section 20 of the *Trademarks Act*. This case is still pending.

Registration

Every consideration should be given to registering domain names in the jurisdictions where substantial Internet activity is expected, and in the jurisdiction applicable to the registrar who issued the name. Registration will also ensure compliance with the applicable registrar's domain name policy. There are several other advantages to registration relating to general trademark law: Registration is constructive notice of ownership and assists in defeating a good faith defence for use of a similar or identical mark; it gives nation-wide priority as of the date of registration; it gives access to the courts for relief and evidence of the validity of the mark.

Hyperlinks

Hyperlinks allow users to move from one Web-Site to another or from one page within a Web-Site to another by clicking on a highlighted word or symbol. Grounds of trade mark infringement and copyright infringement have been advanced as potential constraints on hyperlinks. A link which allows the exploitation of the content provided on another site, constitutes a wrongful appropriation of commercially valuable intellectual property. No Canadian cases have addressed hyperlinking. However, a number of provisions of the *Trade Marks Act* may apply[24].

PRIVACY ISSUES

Issues of privacy including limitations on collection and use of personal information have become a key focus of potential regulation affecting Internet commerce. This information is often collected for the purpose of: 1.) creating profiles for an advertiser's target marketing activities, 2.) calculating traffic levels in order to induce advertisers to buy space on the site. A recent survey of Web-Sites conducted by the United States Federal Trade Commission confirmed that a large number of advertisers collect information from Web-Site visitors. Of the 674 sites included in the survey, 92% were found to collect personal information. Only 14% of those provided any notice regarding their information practices, and only 2% had comprehensive privacy policies[25] on the site.

Areas of Concern

The Internet provides a powerful vehicle for data collection. There are three basic avenues for potential information collection: (a) information actively provided by users when they visit a Web-Site; (b) transaction-generated information (TGI) which is left involuntarily by a user on a visit to a Web-Site; and (c) “cookies”.

Information Actively Provided By Users

Frequently, Web-Site visitors are asked to provide personal information including basic identification and billing information (name, address, telephone number, email, credit card number), demographic information and interests. Requests for this type of information are commonly found on registration pages, user surveys, on-line contests and order forms.

Transaction Generated Information (TGI)

An “electronic footprint”[26] summarizes transmission time, the length of the visit, the number and identity of pages visited and the user’s type of browser and Internet address. The privacy concern is that this information collected over time can be used to create a detailed picture of the individual, his or her interests, all without the person’s knowledge or control.

Cookies

“Cookies” are a specific form of TGI. They are digital files transmitted to and placed on a visiting computer’s hard drive by a web browser or host Web-Site. Each time the user visits a Web-Site, the server which sent the “cookie” to the visitor’s hard drive, accesses the information stored on it and reviews what the user has browsed on the site previously. Cookies are used to expedite entry into Web-Sites that require member qualification by storing the data required for access. The quality of personal information stored on a cookie is quite high because it is constantly updated.

Voluntary Standards

Voluntary standards of privacy are evolving. Some Web-Site operators develop, post and presumably abide by Privacy Statements, which are prominently displayed on the main page on a Web-Site. Typically, access to the text of policy is by a hyperlink.

We have reproduced, for informational purposes, the following two samples of typical Privacy Statements:

> ***First Example:***
>
> **Protecting your Privacy**
>
> We will take appropriate steps to protect your privacy. Whenever you provide sensitive information (for example, a credit card number to make a purchase), we will take reasonable steps to protect it, such as encrypting your card number. We will also take reasonable security measures to protect your personal information in storage. Credit card numbers are used only for payment processing and are not retained for marketing purposes.

As mentioned above, we will not provide any of your personal information to other companies or individuals without your permission. We will need to provide your name and delivery address to a trusted shipping or fulfilment company if you have asked us to send something to you.

Second Example:

On-line Privacy Policy

Your right to privacy is very important. We recognize that when you choose to provide us with information about yourself, you trust us to act in a responsible manner. We believe this information should only be used to help us provide you with better service. That's why we have put a policy in place to protect your personal information.

What personal information do we collect?

In general, when you visit our web sites and access information you remain anonymous. We will not provide any of your personal information to other companies or individuals without your permission. We collect only that information that we need in order to maintain a high level of customer service to you. Sometimes that is only a name and an email address, but in some circumstances, we need to have more information.

Protecting your Privacy

We will take appropriate steps to protect your privacy. Whenever you provide sensitive information (for example, a credit card number to make a purchase), we will take reasonable steps to protect it, such as encrypting your card number. We will also take reasonable security measures to protect your personal information in storage. Credit card numbers are used only for payment processing and are not retained for marketing purposes.

As mentioned above, we will not provide any of your personal information to other companies or individuals without your permission. We will need to provide your name and delivery address to a trusted shipping or fulfilment company if you have asked us to send something to you.

Privacy Laws

Common Law

The traditional view is that there is no protection for personal privacy per se in Canada[27]. However, there are causes of action that exist at law and equity that protect private interests. Examples are trespass, defamation, breach of confidence, passing off and appropriation of personality.

Legislation affecting Public Institutions

The federal government and most provinces have enacted legislation that governs the collection, use and disclosure of personal information held by them[28]. Certain criteria are set forth in these Acts to assist in reaching a conclusion on whether a disclosure of personal information constitutes an unjustified invasion of personal privacy. Such criteria may include: whether disclosure is desirable for the purpose of subjecting the activities of the institution to public scrutiny, whether the information is highly sensitive, whether it is likely to be inaccurate or unreliable, whether it was supplied in confidence, and whether the disclosure may damage the reputation of any person in the record. Circumstances describing an unjustified invasion of personal privacy include the release of information which describes an individual's finances, income, assets, liabilities, net worth, bank balances, financial history or activities, or credit worthiness; information that relates to medical, psychiatric or psychological history, diagnosis, condition, treatment or evaluation; or indicates the individual's racial or ethnic origin, sexual orientation or religious or political beliefs or associations. There are certain instances where disclosure does not constitute an unjustified invasion of privacy. (e.g. where it discloses financial or other details of a contract for personal services between an individual and an institution.)

There is no federal legislation that protects information that is collected in the course of private transactions. However, this may change with the federal government's recently introduced Bill C-54, the *Personal Information Protection and Electronic Documents Act*.

Bill C-54 (Recently reintroduced as Bill C-6)

As at the date of this paper (November 4, 1999), the Bill was given second reading by the Senate.

Part I of the proposed Act will protect personal information that is collected, used and disclosed in the course of commercial activities. Specifically, it will require consent to the collection and disclosure of personal information.

Bill C-54 substantially incorporates the Model Code for the Protection of Personal Information, Q-830, (Model Privacy Code) which was adopted as a standard by the Canadian Standards Association in 1996. The Model Privacy Code reflects the OECD's Guidelines on a Protection of Privacy and Transport of Flows of Personal Data, adopted in 1980. While the proposed Act will apply to personal information collected and used in any media, it is intended to have a specific impact on information collected on the Internet[29].

One of the purposes of Bill C-54 was to enable Canadian Internet advertisers to meet the minimum standard for data use as laid down in the European unions *Directive on the Protection of Individuals with Regard to the Processing and Personal Data and on the Free Movement of Such Data*. The directive became effective December 15, 1998. It requires EU member states to pass legislation restricting the transmission of personal information to other member states which have not enacted similar legislation. This restriction also applies to data that flows from EU countries to those outside the EU including Canada. It is not clear that, even with the passage of Bill C-54, whether Canada would comply with the extent of protection stipulated in the EU directive. It remains to be seen what impact the EU directive will have on Internet advertising worldwide, given the fact that 80% of the Internet commerce emanates from the United States. There is no legislation similar to this directive in the United States.

Privacy-Tort Legislation

Four Canadian provinces (Newfoundland, Saskatchewan, Manitoba and British Columbia) have enacted statutes to create a tort for a person who violates the privacy of another person. This legislation prevents the use of a person's likeness, name or voice for advertising, sales promotion or other commercial use without the person's consent. To be actionable, a breach of privacy must be "substantial". Part of the analysis includes an expectation of privacy that is determined on the facts of the case[30].

Québec

At present, Québec is the only Canadian jurisdiction that has enacted comprehensive privacy legislation aimed at the private sector. *An Act respecting the protection of personal information in a private sector* [31] (the "*Privacy Act*") allows individuals to access personal information held by the private sector. It also regulates the collection, disclosure and use of personal information by the private sector.

Under the *Act*, an organization can only collect the information necessary to provide a service or sell a product. It is obligated to inform the person concerned before or at the time it collects the information of: (1) what use will be made of the information; (2) who will have access to it, and (3) to whom the information will be disclosed. The organization must take reasonable precautions against unauthorized access and modification of the data. Generally, organizations are prohibited from disclosing the information they have collected to a third party. They are also prohibited from using that information for a purpose other than for which it was collected, unless consent to such use was given. Any consent given, must be "obvious, free, and enlightened". These obligations are very similar to those contained in Bill C-54. "Personal information" for the purposes of the *Privacy Act* is information that concerns a natural person and can be used to identify that person. Of course, this includes the names, addresses or telephone numbers of natural persons.

RELEVANT INTERNATIONAL AGREEMENTS

Activities carried on over the Internet can have consequences in many jurisdictions. No single authority controls or has jurisdiction to regulate the Internet. Most domestic legal systems are based on the principle that sovereign states have exclusive jurisdiction in their own territories. This principle is reflected in the public international law principle that each state has jurisdiction to make and apply its own laws within its territorial boundaries. In situations, where multiple states could rightfully claim to have jurisdiction over a matter, this matter might be subject to unexpected, haphazard, uncoordinated, regulation from more than one jurisdiction. To reduce the risks and costs associated with multi-jurisdictional regulation, states enter into treaties and agreements designed to develop laws of universal application.

There are no international treaties that deal specifically with the Internet yet, although some treaties contain provisions that may apply to the activities carried out on the Internet.

WIPO Copyright Treaty

WIPO treaties oblige signatory states to implement legal protection for intellectual property rights. These treaties grant to the owners of copyright, the exclusive right of communicating their works to the public in such a way that the public may access these works "on demand". i.e. from a place and time individually chosen by them. This provision seems to address the issue of copyright on interactive transmissions on the Internet. WIPO copyright protection extends to work available on the Internet even when it is not accessed.

Uniform Electronic Commerce Act

The Uniform Law Conference of Canada, a working group which consists of representatives of the federal, provincial and territorial governments, has proposed the implementation of the *Uniform Electronic Commerce Act* (UECA)[32]. The UECA is the Conference's attempt to implement the United Nations Model Law on Electric Commerce. The Uniform Law Conference of Canada has now adopted UECA as a uniform act and has recommended it to its member jurisdictions for enactment.

The UECA has two parts, one for general records and one for government records. The intention is to give the government more control over the use and the inflow of electronic information. Some of the key sections are reviewed here:

(a) Section 3 of the UECA states that information shall not be denied legal effect solely on the grounds that it is in the form of an electronic document. Section 3 ensures equal legal effect to electronic documents in the absence of specific rules that would deny the effect.

(b) Section 5 deals with the provision of information. In order for a document to have been provided to someone, it must be under the control of that person. In addition, the information contained in it must be accessible so as to be usable for subsequent reference. This section is important with respect to notices on a Web-Site. The notice would not satisfy section 5 until the intended recipient of the notice actually downloads it.

(c) Section 6 has similar rules to section 5 but deals with prescribed forms.

(d) Section 7 states how one satisfies a demand for originals.

(e) Section 8 is the signature rule. It requires that a person signing a document should choose a method that indicates the person's approval of what is signed. The legal effect of the signature is left to the general law. The signature may be connected to the document in many ways i.e. it may be incorporated in to, attached to, or logically associated with it. The UECA does not define an electronic signature.

CONCLUSION

It is incumbent upon any organization proposing an Internet or e-Commerce presence to develop and implement an organizational strategy which not only addresses the functional, business and technical elements, but also regulatory compliance issues. This paper has demonstrated that these compliance issues are numerous and varied. It also demonstrated that it may be difficult for an organization to protect intellectual property placed on the Internet. To deal with these Internet and related e-commerce “pitfalls” it may be wise for organizations to request the assistance of legal counsel. Hopefully, this paper has provided some of the basic knowledge your organization needs to identify possible problem areas.

SCHEDULE “A”

Web-Site Ownership Agreement

(Sample Ownership and Rights Provisions)

Ownership and Rights

12.1. Ownership of work product by Customer. Except as set forth below, all elements of all Deliverables shall be exclusively owned by Customer and shall be considered works created by Developer for Customer. Except as set forth below, Customer shall itself exclusively own all Canadian and international copyrights and all other intellectual property rights in the Deliverables.

12.2. Vesting of rights. With the sole exception of any Pre-existing Works identified in section 12.3 hereof, Developer agrees to assign, and upon creation of each element of each Deliverable automatically assigns, to Customer, its successors and assigns, ownership of all Canadian, United States and international copyrights and all other intellectual property rights in each element of each Deliverable. This assignment shall be operative with respect to all intellectual property and moral rights in and to each element of each Deliverable. This assignment includes, without limitation, any and all rights to secure any renewals for extensions of copyrights in Canada, the United States and elsewhere and transfers to Customer any and all rights of action and recovery, if any, possessed by Developer for past infringement by others. Furthermore, Developer hereby waives all moral rights in each element of each Deliverable on behalf of itself, its employees, and those of its subcontractors engaged in creation of the Deliverables.

12.3. Developer shall obtain from each and every of its employees, agents, and subcontractors involved in creation each element of each Deliverable any agreement or assignment required to confirm ownership rights in the Deliverables in favour of Customer as well as evidence to confirm waiver of all moral rights therein.

12.4. From time to time upon Customer’s request, Developer and/or its personnel shall confirm such assignments by execution and delivery of such assignments, confirmations of assignments, or other written instruments as Customer may request. Customer, its successors and assigns, shall have the right to obtain and hold in its own name all copyright registrations and other evidence of rights that may be available for the Deliverables and any portion(s) thereof.

12.5. Pre-existing works. In the event that any portion of any Deliverable (including the entirety thereof) constitutes a pre-existing work for which Developer cannot grant to Customer the rights set forth in paragraphs 12.1 and 12.2 above, Developer shall specify below:

(a) the nature of such pre-existing work;

(b) its owner;

(c) any restrictions or royalty terms applicable to Developer's or Customer's use of such pre-existing work or Customer's exploitation of the Deliverable as a Derivative Work thereof; and

(d) the source of Developer's authority to employ the pre-existing work in the preparation of the Deliverable.

12.6. The works set forth above will be referred to as "Pre-existing Works". The only pre-existing works that may be used in the construction of any Deliverable are the Pre-existing Works specified above and any Pre-existing Works that may be approved in writing by the managing partner of Customer prior to their use. Further, before initiating the preparation of any Deliverable that contains one or more such Pre-existing Works, Developer shall, at Developer's sole expense, cause Customer, its successors, and assigns, to have and obtain the perpetual, irrevocable, nonexclusive, world-wide, royalty-free right and license to:

(a) use, execute, reproduce, display, perform, distribute internally or externally, sell copies of, and prepare Derivative Works based upon all Pre-existing Works and Derivative Works thereof, and

(b) authorize or sublicense others from time to time to do any or all of the foregoing.

12.7. Indemnification/no infringement. In performing services under this Agreement, Developer agrees not to design, develop, or provide to Customer any items that infringe one or more patents, copyrights, trade marks, or other intellectual property rights (including trade secrets), privacy or other rights of any person or entity. If Developer becomes aware of any such possible infringement in the course of performing any work hereunder, Developer shall immediately so notify Customer in writing. Developer agrees to indemnify, defend, and hold Customer, its partners, employees, representatives, agents, and the like harmless for any such alleged or actual infringement and for any liability, debt, or other obligation arising out of or as a result of or relating to:

(a) the Agreement;

(b) the performance of the Agreement, or

(c) the Deliverables.

This indemnification shall include attorneys' fees and expenses, unless Developer defends against the allegations using counsel reasonably acceptable to Customer.

13. Agreements with Employees

No individuals or entities other than Developer and Developer's employees shall undertake any work in connection with this Agreement. Developer shall obtain and maintain in effect written agreements with each of its employees who participate in any of Developer's work hereunder. Such agreements shall contain terms sufficient for Developer to comply with all provisions of the Agreement and to support all grants and assignments of rights and ownership hereunder. Such agreements also shall impose an obligation of confidence on such employees with respect to Customer's confidential information. It shall be sufficient compliance with this provision of the Agreement if each such employee reads this Agreement and indicates their consent to abide by its terms by signing and dating this SDA or by initialling and dating this paragraph of this SDA.

14. Representations and Warranties

Developer makes the following representations and warranties for the benefit of Customer, as a present and ongoing affirmation of facts in existence at all times when this Agreement is in effect:

14.1. No conflict. Developer represents and warrants that it is under no obligation or restriction, nor will it assume any such obligation or restriction that does or would in any way interfere or conflict with, or that does or would present a conflict of interest concerning, the work to be performed by Developer under this Agreement. Customer understands that Developer is currently working on one or more similar projects for other clients. Provided that those projects do not interfere or conflict with Developer's obligations under this Agreement, those projects shall not constitute a violation of this provision of the Agreement.

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[1] *R. vs. The Integrity Group Canada Inc.* (Alta. Q.B.), December 16, 1997.

[2] C. Raquel Larabee-Larabie-LeSieur, "Misleading Advertising on the Internet: Competition Law Enforcement in the Electronic Market Place", Speech by the Deputy Director of Investigation and Research (Marketing Practices) to Canadian Corporate Shareholder Services Association Conference, "Fraud on the Internet," September 19, 1996.

[3] R.S.C. 1985, Chap. C-34

[4] R.S.O. 1990, Chap. L-19

[5] However, it is still a criminal offence to make a representation to the public which is false or misleading in a material respect where the representation is made for the purpose of promoting, directly or indirectly, the supply or use of a product or for the purpose of promoting, directly or indirectly, any business interest by any means whatsoever. Section 52(1) of the Competition Act.

[6] Interim orders are an important issue in advertising because they will determine whether a particular advertising campaign will live or die. The interim cease-and-desist orders have a maximum life of 14 days. The orders shall be sought on at least 48 hours notice to the person against who the order will apply. An order can be obtained if there is a strong *prima-facie* case that serious harm is likely to ensure without the order.

[7] The Bureau is adamant that "Administrative monetary penalties" are not fines. Unpaid penalties are treated as debt to the Queen, rather than as a contempt of court.

[8] *R. v. The Cameo Sleep Shop Ltd.* (Ont. Prov. Crt. March 11, 1996).

[9] *Purolator Courier Ltd. v. United Parcel Service Canada Ltd.* (1995) C.P.R. (3d) 473, (Ont. Gen. Div.).

[10] Sections 2.06(1)(a-d).

[11] Knox Insdus. Corp. v. State, 258 P.2d 910 (Okla. 1953).

[12] An Act respecting lotteries, racing, publicity contests and amusement machines, R.S.Q. c.L-6.

[13] The Copyright Act has been interpreted broadly in its application to new forms of expression. Apple Computer Inc. v. MacKintosh Computers Ltd., (1986) 8 C.I.P.R. 153.

[14] Gahtan, Kratz, Mann, Internet Law (1998) at p.133

[15] *Foresight Resources Corp. v. Pfortmiller*, 719 F.Supp. 1006 (D Kan. 1989)

[16] *Ryan et. al. v. The Uncover Company and Knight-Ridder Information, Inc.*

[17] Under the UCC, a form of copyright notice is a condition precedent to a claim of rights.

[18] Section 3(1) of the *Copyright Act*

[19] A key section the *Trademarks Act* is Section 22 , which provides that no person "shall use a trade-mark registered by another person in a manner that is likely to have the effect of depreciating the value of the good will attaching thereto".

[20] The NSI/InterNIC monopoly is being dismantled. In an agreement between the US government and NSI, a non-profit corporation, (Internet Corporation for Assigned Names and Numbers), ICANN will administer the domain name system.
[21] *Inset Systems Inc. v. Instruction Set Inc.* (1996) U.S. Dist. LEXIS 7160
[22] (1995) 61 C.P.R. (3d) 334 (P.E.I.S.C.)
[23] (1997) 77 C.P.R. (3d) 486, (F.C.T.D.)
[24] Section 7 contains provisions which address unfair competition including causing confusion as to the source of any product, passing off and using a misleading description as to character, quality or mode of manufacture of a product. Under Section 20, "infringement" is deemed to include the use of another person's trade mark in a manner that is confusing with a second trade mark. Section 22 prohibits the use of another person's trade mark in a manner likely to depreciate the value of the goodwill attached to it.
[25] FTC Report on Consumers' on-line privacy June 4, 1998
[26] J. Sessler, "Computer Cookie Control; Transaction Generated Information and Privacy Regulation on the Internet" (1997) 5 J.L. & Pol. 627 (Lexis)
[27] *Bingo Enterprises Ltd. v. Plaxton* (1986) 26 D.L.R. 4th 604 (Man. C.A.)
[28] The *Federal Privacy Act* applies to all government departments, most Crown agencies and some Crown corporations. Similar legislation applying to the provincial governments came into effect in 1987. Throughout 1988 and 1989, its application was extended to community colleges, district health councils and agencies.
[29] For example the Bill includes e-mail addresses as part of the definition of "personal information". The Bill requires any advertiser who wishes to use an individual's email address to obtain consent from that person and disclose the purpose before seeking consent.
[30] *Silber v. B.C. Broadcasting System* (1985), 25 D.L.R. (4th) 345 (B.C.S.C.).
[31] *S.Q. 1993, Chap. 17.*
[32] The Conference has traditionally played the role of a harmonizer of statute law.

WHAT IS IT WORTH?

WHAT IS IT WORTH?

Leo Raffin[*]
Lang Michener Lawrence & Shaw
Vancouver, British Columbia

Central to all business transactions is a determination of the value that will pass between the parties. As you might expect, the determination of value is often the central item of contention between parties. Failure to take into consideration each party's return requirements or to take an objective view of value, could significantly affect your ability to complete a financing transaction. I'd like to provide some general comments on certain aspects of how institutionalized (for our purposes, professional) private capital investment works and then provide a brief summary of some of the key analytical tools used to determine the value of an enterprise, in particular where the investment will be made in a private company.

Stripped down to its most basic element, the process of attracting private capital is no different than all other economic transactions in a free market: sellers and buyers must each agree to exchange something of value, in our case, cash for equity in an enterprise, at a price such that both parties feel they will be receiving something that has an acceptable value to each participant. The challenge in attracting equity investment is to demonstrate to potential investors, whose investment decisions will be principally driven by a desire to obtain an adequate return on their investment, that the investment they make in a private company will be sufficient to generate the investor's "expected rate of return." This expected rate of return is the return that the market requires in order to attract funds to a particular investment and, as a result, becomes the enterprise's "cost of capital."

In the arena of institutional private equity investing, where professional investors pursue a portfolio of investments for the principal purpose of wealth accumulation (as distinguished from a private investor such as a family member or friend who may be driven by other considerations), the considerations that go into the determination of what is an appropriate rate of return for that investor go beyond simply a review of the prospects for a particular business. A chief component of the analysis will take into account how that investment fits into the portfolio of investments held by the private investor and how an investment in a particular enterprise may contribute to achieving their return objectives.

Price paid for equity and the value estimated for an enterprise, all other things being equal, are the two key information elements that enter into the investment decision mix. To understand whether the proposed price will be acceptable to a provider of private equity, it would be useful to understand the general manner in which venture capitalists, and increasingly how angel investors, think. An excellent analysis of how venture capital works can be found in an article published in the Harvard Business Review.[1] This should be

[*] I would like to thank Robert Levis, CFA, Chief Executive Officer, Altara Securities Inc. and Pardeep Sangha, Ventures West Management Inc., for their comments.

required reading for any entrepreneur seeking to embark on the task of raising private capital. The following is a summary of the key elements of this article:

- The primary sources of funding for early innovation are corporations (through their internal research and development efforts), government bodies (through the sponsorship of basic scientific research), family and friends, venture capitalists or other professional private investors, and, less frequently, the investing public.

- Venture capitalists and other sophisticated private investors tend to prefer investments where they can assist in the growth of the target company's "infrastructure." What constitutes "infrastructure" varies depending on the business, but it generally means those investments that can provide the opportunity for the company to achieve its growth potential. These investments can range from increased research and development expenditures for product development, acquisition of assets for manufacturing or an expansion of marketing sales forces. The key to this strategy is the making of an investment at an early enough stage to allow the target company's business to grow to a sufficient level so as to attract new buyers for the company's equity and earn the private investor an attractive return.

- The principal methods whereby venture capitalists obtain liquidity for their investment is through the sale of their stake in the enterprise to another party, either by the sale of the entire business or through the public markets.

- Most private investments fail to deliver an adequate, or any, return to investors. Even a well-managed company in a growing industry may still have only a small overall chance of success (see the probability table on page 136 of the Harvard Business Review article for an example of some sobering math).

- Venture capitalists themselves are competitors for equity. To attract investment from other money managers such as pension funds, insurance companies and other financial firms or trustees, the fund manager must demonstrate to these investors that they can generate attractive returns within an acceptable risk profile.

As fund managers, venture capitalists will evaluate an investment in your business based not only on the merits of that particular investment, but how well it fits into their overall portfolio and how it can be expected, at the price being paid, to add to the overall expected return of the portfolio. The historic benchmark rate of return for most venture capital funds is between 25 and 35% per year (with the trend perhaps rising) over the lifetime of the fund. In order for a venture capital fund to meet its investors' return expectations, the venture capitalist looks for investment opportunities that will provide a return that is higher than the return that is expected to be delivered by the venture capital fund to its investors.

The expected required return for the portfolio, along with the valuation applied to a particular investment opportunity, play key roles in determining the price most private investors are prepared to pay to purchase equity in an enterprise. Not a startling conclusion, really, as this is how properly informed investors operate in the public markets. They, however, are most likely seeking more modest returns given that the risk of loss associated with investing in the more mature businesses that are found in the public markets is often less than for investments made in private companies.

If a venture capitalist or other private investor makes an investment with at least one eye on the overall return of their portfolio of investments, the other must be focussed on value ascribed to the target company and the price paid for each investment. The value assigned to an enterprise is one of the key variables in determining the private investor's willingness to pay a particular price for equity. Again, there is no secret to the valuation methods most commonly applied, and descriptions ranging in complexity can be found in a number of published and widely (and not so widely) available sources.[2]

The value of a business is generally measured by determining the market value, estimating a fair market value and assigning a value on the basis of a review of comparable companies. Each of these measures is better suited for certain applications. Even if you intend to rely upon an expert to assist you in any valuation discussion, having at least a understanding of the basic theory of each model is essential for any executive seeking to have productive and if not stress-free at least stress-less, experience in the area of corporate finance. A detailed description of each of these valuation models and their components is beyond the scope of these notes (and my expertise), but a summary description of key concepts is as follows:

- **Market value** is the aggregate price at which a company's securities (both equity and, if applicable, debt) trade in the financial markets. It is a measure best used where the company's securities are highly liquid (i.e. trade frequently). It is not an adequate measure of enterprise value when you are dealing with private firms.

- **Fair market value** is the price at which an asset would trade between well-informed rational trading partners, neither of whom is under any pressure to sell. There are several ways to determine fair market value, the two key measures being a valuation based on a going concern analysis (valuing the business on the assumption that it will continue in operation in perpetuity) and the liquidation approach (valuing the business on its break-up value). The fair market value of the firm is usually the higher of its liquidation value or its going concern value. Most equity investments, especially those dealing with private companies, are made on the basis of valuing the business as a going concern.

- The **market comparables** approach seeks to determine a price for equity on the basis of the price at which securities of other companies have traded. For this comparison to be meaningful, it must be made between firms that have similar cash flow and business and financial risk. The comparables approach is utilized both in valuing public and private companies, though gathering information on private company trading values is obviously more difficult. This is a highly subjective approach to valuation and requires considerable thought in selecting an appropriate sample of comparable companies and in making adjustments to the values to account for a lack of marketability (if you are comparing a private to a public company) and any required discount or control premium.

- Going concern value can be determined through several calculation methods. The most common method used for investment purposes is to estimate the aggregate future economic benefits to the owners (usually cash flow) that the enterprise is projected to generate, and then discounting these benefits to a present value at an appropriate discount rate. In this model, the proper estimation of cash flow and the discount rate are critical. Cash flow, as a measure of future economic benefits, is often defined as "free cash flow" or "net cash flow" (typically earnings less capital expenditures and additions to working capital). The discount rate used to arrive at the present value of the enterprise is the expected rate of return that would be required to attract capital to the investment. The rate is generally calculated using models which focus on investment returns with comparable risks (the capital asset pricing model) or the value of the company's weighted average cost of capital (for both equity and debt). In simplified terms, the discount rate is determined by adding together the "risk-free rate" (the amount an investor feels certain of realizing over their investment period) and a premium for risk (which includes the risk related to movements in the investment markets and a risk that is specific to the investment).

- One of the key considerations in the discounted cash flow calculation is to allow for different levels of growth in the rate of accumulation of free cash flow. For a growing business, this variation can be dramatic. The most common method to account for the variation in growth rates is to assume the enterprise will have two distinct phases of growth. The first phase assumes a rapid increase in free cash flow for a finite period of time (typically between three to 10 years), which is what is expected of a new business in a growing industry. The second phase assumes a constant growth in cash flow into perpetuity, which is what is expected of a business in a mature, stable slow growth industry. The estimated total free cash flow derived from the "growth" phase is discounted to the present, and the estimated free cash flow from the "stable" phase is first capitalized using a capitalization rate (this is called the terminal value) and then discounted to the present. These two values are then added together to arrive at an estimate of the enterprise's value. The terminal value can also be calculated on a basis other than by using a capitalization approach such as liquidation value. Regardless of the method used, the calculation of terminal value is a key consideration as it may be the largest component of the total value of the enterprise.

- A determination of value based on a comparables approach can take many forms. A common method is to determine the appropriate price to earnings ratios for comparable companies that are publicly traded, multiplying it by earnings per share and then adjusting on the basis of lack of marketability (generally a 25% discount). For a company with no earnings, an alternative comparison, such as price to sales, may need to be used. A comparable analysis might also take the form of a review of equivalent private company transactions to determine the prices paid for investments that are equivalent to the investment being contemplated.

- Each valuation method involves significant estimation work for many of the key assumptions. The key elements of the discounted cash flow model - estimated cash flows, discount rate and terminal value - are not known with certainty, but arrived at following a good faith analysis of available data. The comparables approach also can suffer from significant error as finding enterprises with close correlations in the area of risk and cash flows can be challenging. Further complexity in the calculation will also be added if you try to provide for a range of possible values. One method sometimes used (the First Chicago method) estimates a range of values based upon certain assumptions as to the success of the business (failure to very successful and a couple of points in between), assigns a probability to the occurrence of these outcomes, then calculates a company's value on the basis of a weighted average.

- The valuation model used will depend upon the company and industry being analyzed, and the opinion of the valuator as to which model will yield the more accurate estimate. For example, a comparables approach, especially one that reviews equivalent private company transactions, may be favoured by certain venture capitalists.

Once value is estimated, the next key amount, price, can be negotiated. In private company investment, a number of considerations affect the negotiation including, perhaps most importantly, the investors' required return and whether there is competition for the investment opportunity.

One of the key elements in the successful development of any enterprise is the management of risk. For management of a start-up or developing business with ambitious growth plans, a key risk is the location of suitable sources of capital in amounts and at prices acceptable both to the investors and the current owners. An understanding of how venture capital or "institutional" private investment works, and the most common valuation principles applied, may better equip those ambitious managers for the struggle ahead. This understanding may not make the task of prying open the venture capital purse strings or the inevitable battles over price and value any more pleasant, but it may remove some of the emotion that often accompanies these discussions and facilitate the completion of transactions between the parties.

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[1] Bob Zider, "How Venture Capital Works", Harvard Business Review November-December, 1998 Pages 131 - 139. You may also want to review William A. Sahlman, "How to write a Great Business Plan", Harvard Business Review July-August, Pages 98 – 108 for a good discussion on the preparation of a business plan.

[2] Certain of the materials I reviewed for these notes are Robert C. Higgins, Analysis for Financial Management, 5th ed. Edition, Irwin/McGraw-Hill, 1998; Ian R. Campbell, Canadian Valuation Service, Student Edition 1994, Carswell; and Samuel J. Thompson Jr., "A Lawyer's Guide to Modern Valuation Techniques in Mergers and Acquisitions", Journal of Corporation Law, Vol. 21, No. 3, Pages 457-539. Mr. Higgins' book has a useful bibliography of additional sources.

RULES FOR ADVERTISING AND MARKETING ON THE INTERNET

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INTRODUCTION

"E-Commerce expected to explode, OECD says" read a recent headline in *The Globe and Mail Report on Business*.[1] The newspaper article was referring to an OECD research paper which concluded that commerce on the Internet will reach a trillion dollars (U.S.) within the next seven years, dramatically up from the current $26 billion. However, it was noted that consumer transactions still form a small portion of all business conducted on the Internet, with about 80% being accounted for by business to business transactions. The OECD report also noted a perception prevalent among many government and industry representatives that the Internet must become more secure and conform with mainstream consumer protection and marketing standards before consumer participation experiences really significant growth.

This perception - that more regulation is required if e-commerce is to grow - highlights the tension between the essentially two opposing philosophies of how the Internet should evolve. On one side of the debate are the original "Netizens" who view the Internet as a dramatically freer form of speech than ever before which can only grow and reach its full creative potential if left essentially open and unregulated. On the other side are those promoting a more regulated Internet. The "more regulation" philosophy is gaining favour, not only as a strategy to respond to statistics such as those cited by the OECD, but in large measure in response to increasing misuse and fraud by unscrupulous Internet advertisers and web merchants. Many initiatives at both the legislative and industry self-regulatory levels have been undertaken over the past eighteen months to address these concerns. These initiatives, together with parallel efforts to enhance the security of transactions and to provide protection of financial data, are seen as necessary if consumers are to gain the confidence that will enable them to become a major element in the e-commerce marketplace.

The OECD paper also suggested that, as this evolution toward more regulation gains momentum, the Internet will change the way products are marketed, with consumers and businesses dealing in a much closer relationship than before, and traditional intermediary functions being eliminated. While such a major realignment of traditional marketplace functions has yet to occur, it is clear that the Internet offers advertisers a vehicle to reach an almost limitless number of consumers throughout a global marketplace, at a very low cost. Furthermore, consumers can shop comparatively, obtaining detailed information on potential purchases, from a similarly almost limitless range of product offerings. Not only is information ubiquitous and easily accessible but transactions can also be completed in a fraction of the time that we have been used to in the traditional commercial marketplace.

These revolutionary developments pose new challenges for "advertising compliance" and also raise significant issues. The application and enforcement of national jurisdiction-based advertising laws, whether they be statutory or common law in nature, are an example. Product marketers, consumers and regulators alike need to know whose laws apply and what the rules are. In some respects, the question of what rules are applicable is straightforward. For example, the traditional rules governing truth and fairness in advertising apply to the Internet with full force. In other respects however, particularly trade mark and copyright compliance, many of the traditional rights and obligations are being challenged.

Internet advertising has been characterized as "borderless" because, even if the content of a message is restricted to a specific audience, the message will nonetheless be available to users throughout the Internet world. This "borderless" character of the Internet contrasts with almost every other form of advertising, because in the actual communication of the message there is no directive (or "push") aspect. The obverse of this non-directive character of Internet advertising is the specific, selective, search-and-find based nature of a user's access to a particular message. The message is not "broadcast" to the Internet public at large but rather is available to anyone who chooses to view it.[2] To view or access a message, a user in fact "pulls" the information from the server on which it is held down to his or her own computer. Some commentators have argued that this reader/user selection (or "pull" character) of Internet advertising may suggest a lesser requirement for public or quasi-public regulation of the fairness or accuracy for such advertising than for traditional advertising media.[3]

FORMS OF ADVERTISING AND MARKETING ON THE NET

Within the Internet, a variety of vehicles exist to carry advertising.

Web Sites

Web sites represent possibly the most frequently used vehicle for Internet advertising. Web sites offer a means by which advertisers can deliver product information, establish a corporate identity, build brand awareness and loyalty, capture customer leads, provide customer service, conduct sales transactions, and conduct research. Advertisers can measure web site advertising effectiveness by tracking various indicia including the number of visits to the site; the number of "clicks" (or "hits") to their site from an ad on another site; and the volume of product sales through the site.

Banner Advertising

Banner advertising is the single most common technique used for Internet advertising. Banner ads appear on many of the vehicles used by Internet advertisers including web sites, search engines, browser programs and shopping malls.

Shopping Malls

Another vehicle for Internet advertising is represented by shopping malls, also known as shopping precincts (SP's) or cyber malls, which exist only as images on the screen but through which orders can be placed and payments made. Many predict that this will become the attractive form of electronic retailing for most consumers in the future. As an example, CompuServe has featured six well-known UK retailers. In addition, individual promoters are also providing a broad range of services which include purchasing of automobiles, books, and on-line trading.

Private Networks

Private networks or intranets operate over dedicated lines, and are available exclusively to their subscribers or users. Such networks are commonly used today in many office and corporate environments for internal business purposes. Large, commercial intranets, such as "@Home Canada", constitute another platform for content providers and advertisers. @Home provides access to its own proprietary network, as well as to Internet sites. One major benefit of @Home is faster access to the Internet by caching and replicating Internet content, including advertising, onto the private network. In addition to Internet advertising, @Home subscribers can access content from advertisers who decide to bypass Internet traffic altogether, and connect directly to the @Home network. A private network such as @Home may also allow users the ability to hyperlink directly to sites on the Internet.

Electronic Bulletin Boards

Advertising may also appear on bulletin boards, Usenet news groups and listserve mailing lists. Many bulletin boards allow for products or services to be posted, including by competing advertisers, and can be focused onto special interest groups. This forum has also been used to counter misleading advertising. Netizens have begun to fight back against on-line misleading advertising by placing their experiences on bulletin boards for other users to become aware of. In a recent example, a user purchased a software package which failed to include all the elements advertised. He initially downloaded the program and tested it. He then filled out the order form and paid the $50.00 fee for the latest version of the software, manuals and on-line support. However, when he received the package in the mail, he realized that he did not receive the manual nor did he receive the latest version of the software as indicated in the order form.[4]

Search Engines

Advertising is also found on the search engine pages, most commonly in the form of banner ads. For instance, when you search on Yahoo!, you will find an advertising message (often a contest or promotion) which allows you to click onto it and hyperlink into a site containing further information about the advertised product or promotion.

Browser Programs

Browser programs, such as Netscape and Microsoft Internet Explorer, provide several potential opportunities for advertising. For example, the Netscape web site offers banner advertising programs, Netscape destinations programs and net search programs. Banner advertising allows the advertiser to reach potential customers by hyperlinking them from the ad on the Netscape site directly to the advertiser's own web site. Destinations programs represent a means to reach customers within a specific area of interest; once a destinations visitor has selected an advertiser within a category, he or she can link to the advertiser's web site. Net search programs, such as the Netscape Search Page, allow visitors to browse and search their way to general categories or specific information, within which web sites for individual advertisers are listed. Similar opportunities are available on the Microsoft Home Page which is linked from its Internet Explorer.

Direct E-Mail

Direct e-mail is a variation of traditional direct mail advertising and has great potential to reach a very large number of recipients at very low cost. However, the use of mass unsolicited e-mails (or "spams") has become a serious concern from both personal privacy and system support perspectives.

The relative ease of obtaining e-mail addresses over the Internet (through site visits and other contacts) has led to pressure for rules prohibiting unsolicited messages. As well, Internet facilities providers are calling for prohibition or limitations on spamming which clogs their servers and can lead to breakdowns. These concerns have led to initiatives, both in industry codes and in legislation, prohibiting unsolicited e-mail and spams,[5] requiring disclosure of the advertiser's identity, and enabling easy means of reply.

Sponsorship and Advertorials

The Internet technology offers limitless scope for innovative advertisers to integrate their messages into information and communication vehicles available on the Web. Some advertisers, in return for partial sponsorship of a site, obtain a page or simply a banner ad with hyperlinks to their own site. Popular information-oriented sites have offered "advertorials" for related products to be placed within their sites with, of course, links to the advertiser's site. Conversely, those advertisers offer hyperlinks from their web sites to the information-based web site which they sponsor.

Amongst traditional media, rules have developed, or have been imposed, requiring identification of advertising which is presented in the form of editorial content. However, with Internet advertising there are no uniformly recognized rules or established formats in which such commercial interaction with editorial content must be presented.[6]

Web Contests and Sweepstakes

Currently, the single-most popular device used by Internet advertisers to attract interest and web site activity is the sweepstakes or contest promotion. Many of these are simply traditional forms of sweepstakes as seen ubiquitously in other media; however, Web-specific innovations abound. New promotions firms are dedicated to developing Web-specific contests for advertisers clients, including e-mail trivia contests, web site hunts and "hidden questions" contests.[7]

Another more intensively interactive concept is the creation of Web-specific games which have an existence of their own but which may be financially supported by a range of advertisers through sponsorship of elements of the game or prizes. Some of these games are based on traditional board-game formats and others on sports-pick concepts.

ADVERTISING COMPLIANCE

Laws of General Application

Many of the advertising and marketing messages found on the Internet are substantially similar to those seen in other advertising media. Furthermore, in concept, the Internet is simply another medium for conveying these messages (or "representations") to the public. Consequently, the existing substantive rules of advertising compliance apply with full force. However in certain areas, current legislation or industry codes do not address issues raised by the unique nature of the medium. An example is advertising to children. In Canada, through a combination of statutory (*Broadcasting Act*,[8] *Quebec Consumer Protection Act*[9]) and industry voluntary regulations[10], advertising to children over the broadcast media is either restricted as to content or prohibited entirely. No such regulation currently applies to Internet advertising, although active consideration is being given to extending the application of voluntary industry codes to address this area.

Any Internet advertiser whose messages may be subject to the rules of a local, national or supra-national jurisdiction must, as a first consideration, be prepared to comply with the general statutory rules, rights of private action and self-regulatory rules applicable in each such jurisdiction. In Canada, addressing the statutory rules means compliance with prohibitions against false or misleading advertising contained in the federal *Competition Act* [11], *Food and Drugs Act* [12], and *Trade-marks Act* [13] and with certain specific advertising rules contained in statutes such as the *Consumer Packaging and Labelling Act* [14], the *Hazardous Products Act* [15] and the *Textiles Labelling Act* [16]. Certain categories of advertising are (or may become) prohibited altogether; for example, the federal *Tobacco Act* [17] prohibits many forms of mass-media tobacco advertising. At the provincial level, analogous prohibitions against misleading advertising are found in the *Business Practices Acts*[18], or *Consumer Protection Acts*, of the provinces. In addition, advertising of certain specific products, such as alcoholic beverages[19], motor vehicles[20] and margarine[21], is subject to provincial regulation. Apart from these generally applicable prohibitions, productspecific or promotionspecific regulatory rules may have application. For example, an Internet sweepstakes will be regulated by the *Criminal Code* and the *Competition Act* and the *Quebec Lotteries Act*.[22] Furthermore, federal legislation applies to certain advertising or marketing formats. Multi-level marketing schemes are regulated by the *Competition Act* and certain provincial statutes. Promotions using 1-900 numbers are regulated by the *Telecommunications Act*[23] and telemarketing will be regulated under proposed amendments to the *Competition Act*[24].

In the U.S., national regulation of advertising is the purview by the Federal Trade Commission which addresses traditional "offline" advertising through an extensive number of rules and guides covering some forty subjects. As at the provincial level in Canada, regulations governing traditional advertising also exist at the state level. Most of the federal and state rules apply with full force to Internet advertising. Of note, the FTC recently sought comment on a proposed policy statement regarding the applicability of its existing rules and guides to electronic media including the Internet, e-mail and CD-ROMs.[25] The FTC is proposing to formulate a formal policy statement with the purposes of clarifying that most "offline" rules apply equally to online advertising and reducing uncertainty as to how they apply. As an example, the FTC would clarify that the word "written" appearing in its rules and guides refers not only to traditional print or textual advertising but also to any information capable of being preserved in tangible form and read. The proposal also would provide guidance as to how electronic media can be used to comply with the FTC's existing rules such as the requirement for formal disclosure of material information.

The Competition Act

Of primary relevance in Canada is the *Competition Act*, which contains a broadly worded prohibition against making false or misleading representations to the public, directly or indirectly, "by any means whatever". In addition to the general prohibition, the Act contains specific prohibitions against unsubstantiated performance claims, false guarantee claims, false or unauthorized testimonials, misleading price claims, multi-level marketing schemes that fail to comply with disclosure requirements or involve a recruitment fee, bait and switch selling, sales above advertised price and promotional contests that fail to meet minimum disclosure requirements. Currently, these rules are of a criminal nature, meaning that they are prohibitions enforced by criminal sanctions including fines and, potentially, imprisonment. However, under significant amendments to the Act currently before Parliament[26], most of these misleading advertising prohibitions will be transferred to a new civil review regime which will no longer impose criminal penalties but instead will be able to make prohibition orders and grant administrative remedies. This will bring our law into line with American federal law which, under the jurisdiction of the Federal Trade Commission, provides for civil rights of action and administrative remedies including prohibition orders, rather than criminal remedies as we have had to date in Canada.

The proposed amendments to the advertising and marketing law provisions of the *Competition Act* are significant. Most of the current criminal advertising and marketing practices prohibitions contained in sections 52 to 59 of the Act will be repealed by the amendments, and will substantially reappear as reviewable conduct in sections 74.01 to 74.08 (Part VIII.1 of the amended Act). However, the general prohibition of materially false or misleading representations (para.52(1)(a)) will remain a criminal offence, in amended form, as well as becoming a reviewable practice. The provisions relating to pyramid selling and multi-level marketing will remain solely as criminal offences with increased fines.

Deceptive Telemarketing

The amendments will add new criminal provisions dealing specifically with telemarketing - requiring minimum disclosure of specified information and prohibiting entirely certain types of transactions including contests in which a purchase element is contained.[27] These provisions have been proposed in response to a perception of a growing problem of deceptive telephone sales, particularly targeting vulnerable groups such as the elderly. Telemarketing fraud has been identified by the Competition Bureau as a key enforcement priority and the Director under the Act has indicated that passage of the amendments will greatly assist the Bureau's enforcement efforts in this area. The Bureau recently joined with the U.S. Federal Trade commission in a bi-national task force to track down and prosecute cross-border telephone scam artists.[28]

Under the new provisions, telemarketing is defined as the use of interactive telephone communications for the purpose of promoting the supply or use of a product or promoting any business interest. Given the definition, it is not clear whether the provision as currently drafted would apply to Internet advertising, but in the absence of a specific exclusion it is possible that it may apply. By way of comparison it should be noted that the U.S. Federal Trade Commission amended the initial draft of its *Telemarketing Sales Rule*[29] to exclude Internet transmissions.

Disclaimers: Internet Legal Pages

A disclaimer may clarify a representation that in its absence would be materially false or misleading under the *Competition Act* or other applicable law. Disclaimers, common in both print and television advertising, are becoming a significant feature of Internet advertising. Disclaimers may range from a short phrase or sentence to a lengthy small-print text such as found in automobile financing offers, to full pages of text as are now found in "Internet Legal Pages."

Many Internet advertisements and promotions contain extensive disclaimer language that is posted and integrated into the information communicated. Typically, these disclaimers, which may also contain copyright and trademark notices and disclaimers, are presented as "required reading" before the user can click onto the page containing the substantive information. Another concept gaining favour (especially among Internet advertising lawyers) is the "Internet Legal Page" which sets out the "terms and conditions" for users who view the site. The Legal Page typically stipulates every possible right and limitation that the advertiser should claim, including disclaimers as to accuracy of the information posted, limitations of warranties and liability, warnings about use or misuse of proprietary information presented on the site, disclaimers for any defamatory language, limitations as to the reuse of downloaded software, information as to where the advertisement is intended to be read and any qualifications or restrictions that apply to the claims or information presented by the advertiser. In light of the increasing controversy over rights and liabilities relating to hyperlinking (see discussion below), a web site that offers links to other sites should include in its Legal Page, disclaimers of any potential allegation of endorsement or appropriation of rights associated with the linked site as well as a disclaimer of any liability for claims made or statements contained on the linked site.

The basic rule under Canadian law is that disclaimers may be used to qualify or explain the primary advertising message, but a disclaimer which seeks to substantially alter or restrict the primary message (e.g. a “free” claim with a disclaimer indicating that a price must be paid) will not be effective in saving the advertisement from being found to convey a false or misleading general impression.[30] Particularly where the disclaimers are prominent, or in fact contained within the body of the advertisement rather than in fine print, they are more likely to be effective in avoiding a finding that the advertisement is misleading. Similarly, the more sophisticated the audience for the advertisement is presumed to be, the more effective disclaimers are likely to be.[31] The Internet offers useful techniques for present effective disclaimers, as noted above, particularly since there is no need to render a disclaimer in small print as space is not a problem.

Web Contests

Internet contests and sweepstakes under Canadian law must comply with federal legislation, specifically the rules respecting legality of games of chance contained in the Criminal Code and the minimum disclosure requirements stipulated in the *Competition Act*. If contest entry is open to Quebec residents (or is not restricted to entry by Quebec residents), it must also comply with the registration (including payment of duties) and disclosure requirements stipulated in the *Quebec Lotteries Act* (these disclosure requirements are more extensive than required by the *Competition Act*).

While a number of legal issues are raised by Internet contests,[32] possibly the most significant is that of consideration, or conversely, that of eliminating the purchase requirement. In both Canada and the United States, unless a contest requires true skill for the selection of winners, there must be no consideration (or price) paid to enter.[33] While on their face Internet contests may state that “no purchase is necessary” to enter, the true analysis may not be so clear. No one has access to the Internet free of charge; fees are paid to service providers for Internet access and potentially potentially for software used to access or browse a site. It is not clear whether these fees, as well as others, constitute consideration paid to enter an Internet contest. However, a simple, conservative approach to compliance is for the contest promoter to allow equal participation by mail-in or other means on an equal basis with Internet entries.

INTELLECTUAL PROPERTY

Intellectual property law is designed to give an owner of a distinctive creation, usually resulting from his or her intellectual effort, the right to its exclusive use and to grant others the right to use that creation. The Internet, which by its nature is the antithesis of exclusive use, poses significant challenges to this traditional role of intellectual property.

Intellectual property rights, such as trade marks and copyright, are used by their owners to identify or add value to products. When a product appears on the Internet, either for information or for sale, whatever appears on-line may be downloaded anywhere in the world. Therefore, without any clearly qualifying or restricting language, owners of the intellectual property may be taken to have given implied consent to users of their intellectual property. On the other hand, persons who make use of intellectual property found on the Web risk infringement actions if they do not obtain prior permission from or comply with procedures stipulated by the intellectual property owner. An example of potential infringement is an individual who downloads an advertisement for a product, and then prints copies for distribution to friends. A more significant potential infringement occurs when the owner of a web site either downloads material from another site and posts it on its own site, or hyperlinks to another site but maintains its own frame on the screen while the linked site is open.

Copyright

In the United States, bulletin board operators have been held liable for copyright infringement. In *Playboy Enterprises Inc. v. Frena*[34] the court addressed the liability of George Frena, who operated a subscription computer bulletin board service containing directories of adult photographs, some of which were copies of *Playboy Magazine's* copyrighted photographs. These photographs were being downloaded by subscribers without *Playboy's* consent. However, Frena argued that the subscribers themselves had uploaded these particular photographs and that he removed them as soon as he had discovered them. The court found Frena liable because he operated a bulletin board which displayed unauthorized copies, despite the fact that he had not personally put the copies there.[35]

The debate facing copyright law in the age of the Internet is not so much concerned with the issue of infringement as whether intellectual property laws will survive the Information Superhighway and, if so, in what form. On the one side are those who argue that current copyright law, as reflected in the federal *Copyright Act*, is inadequate to meet the challenges of this new technology while others argue that the current law is sufficiently flexible to deal with them. The Federal Government's Information Highway Advisory Council concluded that the current law provides reasonable protection for works appearing on the Internet and other computer networks, and that copyright as the basis for protection is here to stay.[36] However, it recommended a variety of amendments to the current law. For example, it recommended that bulletin board operators should be clearly liable for copyright infringement, while common carriers, such as Bell Canada, functioning solely in that capacity, should be exempt. In the U.S., the recently passed *Digital Millennium Copyright Act* will now protect from copyright infringement ISPs who do not initiate a transmission of copyrighted material and who do not select the material transmitted or the recipients to whom it is directed. [37]

Commentators who claim that the current copyright rules are sufficient and flexible enough to adapt to the changing environment, argue that if one posts something on the Internet then implied consent is being given to have the posted materials copied.[38] The argument is made that if an individual posts a message on the Internet, he or she intends that the message will be downloaded to a local computer in order to be read. By posting a message to a news group bulletin board, the individual is in effect giving a license to others to make copies at least for the purpose of downloading it.

Internet advertisers should be conscious and take steps (e.g. on their Legal Pages) to clearly state ownership of their copyright. Internet advertisers should also state that the use of any material which is subject to their copyright is expressly prohibited--except as they may specifically permit (i.e., downloading to a home computer for personal use). Likewise, advertisers should ensure that they have obtained all copyright permissions for material that they post on their site. Furthermore, they should seek to exclude any liability for material posted to their site by others.

Trade Marks

Internet advertising may raise questions of trade mark infringement on several bases. Traditional cases of trade mark infringement (an advertiser wrongfully using another person's trade mark to identify its goods or services) are relatively straightforward and have been the subject of litigation in both Canada and the U.S. However, a number of Internet-specific trade mark issues are more complex.

Domain Names

By the "domain name" system, web sites or addresses are linked to Internet Protocol addresses; the system allows users to access a site by simply typing into his or her computer a combination of letters and punctuation marks. Examples of domain names include "langmichener.ca" and "columbiahouse.com". Generic suffixes of domain names also include codes for countries (such as ".ca" for Canada, or ".uk" for the United Kingdom) or a category of information carried on the web site (such as ".com", ".org", or ".edu"); such generic suffixes are referred to as top-level domain names.

To date, most domain names have been registered through the Internet Network Information Centre, established by the National Science Foundation in the U.S. and operated by Network Solutions, Inc. NSI assigns names on a first-come, first-served basis. There have been problems with the NSI system caused by registrants attempting to hold domain names for ransom. For example, an individual with no connection to McDonald's Corporation registered the domain name "mcdonalds.com", apparently with the objective of extracting a price from McDonald's if it decided to establish a web site.

From an advertiser's perspective domain names have two important facets. To the extent that the domain name incorporates the advertiser's name or trade mark and is used in widely disseminated advertising, the domain name has a value analogous to a trade mark as a "source identifier" for the advertiser's goods or services. Conversely, if an advertiser's distinctive name or trade mark is embodied in someone else's domain name, thus potentially denying the advertiser the opportunity to use that domain name, it not only suffers the loss of use but may see someone else exploit some of the commercial value of its name. In response to the problems resulting from attempts to register domain names that are the same as or confusing with existing names and other trade marks, NSI has adopted a Domain Name

Dispute Policy to resolve disputes between domain name owners and owners of trade mark rights.[39] NSI now rejects proposed domain names which contain obvious or well-known names or trade marks and will put a domain name on hold if evidence of a prior trade mark registration is submitted to it. The policy requires that applicants represent that the proposed domain name does not infringe anyone's trade mark rights. An application can be challenged if there is a valid trade mark registration and the registration date precedes the activation of the domain name.

The past two years have seen active debate and a number of competing proposals regarding the future of domain name governance. On September 30, 1998, NSI's monopoly on registration of the most common top-level domain names (in the generic top-level domains .com, .org, .gov, .edu and .net) was ended.[40] At issue in the deliberations over future governance are three considerations: proliferation of generic top level domains; dispute resolution procedures; and portability of domain names. Last year, a group representing the Internet community, called the International AdHoc Committee proposed a plan to create seven new generic top-level domains and the establishment of new domain name registration bodies worldwide for each new domain. Registrations would be recorded on a shared data base and would be portable. Disputes would be dealt with under the aegis of the World Intellectual Property Organization by a "Council of Registrars", based in Switzerland.[41]

More recently, the National Telecommunications and Information Administration (NTIA) within the U.S. Department of Commerce released its own proposals for overseeing the domain name system including allowing transition to a more competitive system.[42] The NTIA's proposal, which is supported by the U.S. federal government, includes the establishment of a new non-profit organization to control the domain name system, worldwide. The responsibility for creating this new organization is being assumed by a broad-based group of Internet stakeholders around the world including NSI, the Internet Assigned Names Authority ("IANA" - which until September 30, 1998 had overall control of the domain system in the U.S.), other Internet registries and registrars, service providers, interested businesses and others.[43]

The use of a domain name which is the same as the recognized trade mark of another person, may constitute trade mark infringement or the common law tort of passing off.[44] The courts in the United States have recognized the potential confusion that could result. In *Inset Systems Inc. v. Instruction Set, Inc.*,[45] it was stated that:

> If a company uses a domain name which is identical to the name or trade mark of a company, an Internet user may inadvertently access an unintended company. Thereafter, the Internet user may not realise that the advertisement is actually from an unintended company, or the Internet user may erroneously assume that the source of information is the intended company. As a result, confusion in the market place could develop.[46]

In Canada, Internet domain names were the subject of trade mark litigation in *PEINET Inc. v. O'Brien*.[47] In that case, the plaintiff's Internet service provider had provided them with the domain name "peinet.pe.ca". The plaintiff sought an interlocutory injunction preventing a former employee from using the domain name "PEI.NET", alleging that it was confusingly similar to its own name. The Prince Edward Island Supreme Court rejected the plaintiff's motion on the basis that the defendant's name used upper case letters and separated the "PEI" from "NET" with a period.[48] However in a recent case, the Federal Court has recognized the right of a registered trade mark owner to stop the use of its mark in a domain name registered by someone else.[49]

Given the power of domain names, every effort should be to establish protection for their use by advertisers. A domain name that is or may be used by an Internet advertiser as an address to market its services should be registered as a trade mark. Internet advertisers should register all domain names which incorporate their strongest trade marks. Furthermore, lawyers advising on trade mark applications and giving opinions regarding registrability of trade marks should now conduct searches on domain names.

Hyperlinks

The Internet function which allows users to move from one web site to another or from page to page within a web site, is known as a hyperlink, activated by clicking on either a highlighted word or a graphic symbol on a page.

There are basically two types of linking out of one site to another. The simple, straightforward, form moves the user from the site on which he or she started to a completely different site, which may have no legal or business relationship connection with the first site. The user knows that this type of link has occurred because the uniform resource locator (URL) address on the screen changes from that of the first site to the URL address of the second site. This type of link is made by clicking on a highlighted part of the hypertext in the original site. These links are known as "hypertext reference links".

A more sophisticated form of hyperlinking brings onto the original site images from another. These "image links" allow the linking site to present a seamless image incorporating content from both the original site and the linked site. A variation of this form of linking which also allows a seamless presentation of content between the original and linked sites is known as "framing". Here, a framing site brings within its own web page, entire pages from a linked site, which appear in a window on the original site or in some other way are "framed" by it. The framing portion of the page may include advertisements posted by the original site. In the cases of both image linking and framing the user never actually leaves the original site. In contrast to simple hypertext linking, the URL address on the screen remains that of the original site.

It has been suggested that the ability to direct users from one site to another using hypertext reference links underpins Internet commerce.[50] In the "classic" Internet world of freedom of information flow and user movement, seeking permission to link is considered not required. However as the potential value of Internet commerce and of vehicles for exploiting it grow, web site content providers have become more protective of the information and opportunities for commercial transactions provided on their sites.

Grounds of trade mark infringement, unfair competition, trade mark "dilution" (a U.S. concept not recognized as such in Canada) and copyright infringement have been advanced as potential constraints on hyperlinks. The argument is, simply put, that any form of link which allows a linking site the opportunity to exploit commerce or gain value for its own site through content provided by another site, constitutes a wrongful appropriation of commercially valuable intellectual property which the linked site has an exclusive right to exploit.

While to date no Canadian cases have addressed hyperlinking, several cases in the U.S. and the U.K. have considered the intellectual property issues related to it.

In a Scottish case, *The Shetland Times* newspaper obtained an interlocutory injunction preventing another newspaper, *The Shetland News*, from posting on its web site headlines taken verbatim from the *Times'* web site.[51] These headlines were used as hypertext links to news stories within the *Times'* web site. The decision of the court is an interim one pending final decision at trial and, as such, does not constitute a final determination of the issues. The *Times* argued that the News was infringing copyright in its headlines. There has been much criticism of the decision by Internet users. It is not clear whether copyright protection should extend to headlines (which in the context might be analogized to footnotes in a literary work which simply refer a user to another source). Once inside the *Times'* web site a user was simply viewing the content in the same manner as if it had accessed the site directly, which would not of itself constitute copyright infringement. The *Times'* main complaint was that the links by-passed its home page, going directly to the specific news stories, within its web site, thus creating the impression that the stories originated with the *News*. If not properly based on copyright infringement, the complaint might be based on passing off (a common law action, analogous to trade mark infringement) which gives a person a remedy when its products are misrepresented in a manner that suggests that they are the products of a second person (in this case, the *News*).[52]

In a case which similarly involves hypertext links to within another advertiser's web site, Ticketmaster has sued Microsoft Corporation for what it characterizes as unauthorized links from Microsoft's "Seattle Sidewalk" city guide web site to pages within Ticketmaster's site which offer tickets to Seattle-area sports and entertainment events.[53] Ticketmaster's complaint is that in by-passing its home page, the Microsoft links deny it the opportunity of having a user enter its site through its home page and thereby viewing its own advertising and design features (which presumably are of economic value to it). Ticketmaster is premising its case on a theory of web site dilution, alleging trade mark infringement, unfair competition and trade mark dilution. In its complaint, it treats a web site essentially as a trade mark which may be diluted in value if the owner is not able to control the manner in which other persons use and profit from the services offered on its site.

In a case that involved framing,[54] the *Washington Post* and certain other news media sued Total News in connection with "name brand" news service stories presented on its web site. Total News provided a list of such news services, identified by their trade marks, which could be linked to the web sites for such news services. When a user completed a link the news content of the linked site appeared on the screen surrounded by copy including advertisements from the Total News site. This framing copy covered over advertisements appearing on the linked site. The complaining news services alleged copyright infringement as well as trade mark infringement, false designation of origin and unfair competition. The case was settled under terms which eliminated the framing but allowed Total News to link by hypertext to the news services sites.

As to the copyright claim in the Total News case, the question is whether the framing of content from another site constitutes an infringement of the copyright owner's right to reproduce its original work, or whether the linking site is merely providing a medium of display for works that have been placed in the public domain by their owners. While it is generally felt that the link to a second site's content does not of itself constitute copyright infringement, the framing of that content within text and under the URL address of the linking site may represent an unauthorized reproduction of the original content within a new work (the framing page), which would be infringement.

As no Canadian cases have addressed the question of linking, there is no judicial guidance as to the possible constraints under our law. While the ground of "trade mark dilution" does not exist as such in our law a number of provisions of the *Trade-Marks Act*[55] may have application. Section 7 contains provisions which, broadly speaking, address "unfair competition" including causing confusion as to the source of any product, passing off and using a misleading description as to the character, quality or mode of manufacture of a product. Under section 20 infringement is deemed to include the use of another person's trade mark in a manner that is confusing with a second trade mark. Furthermore, section 22 prohibits the use of another person's trade mark in a manner likely to depreciate the value of the goodwill attaching to it. A number of questions arise in connection with the application of these provisions to hyperlinks, including whether there is confusion or any misleading description sufficient to establish unfair competition or infringement, or whether there is any injury to or depreciation of goodwill of a trade mark owned by a linked site. However, in light of the cases in the U.S. and the U.K., a cautious approach suggests that an advertiser who wishes to link in any manner other than by hypertext link to the home page of a linked site, should consider entering into an agreement with the owner of the site, permitting the link.

License agreements between advertisers having a common business interest in creating links (such a link from a banner ad on one site to the advertiser's home page) have been used for several years and may form a precedent for linking agreements generally. These agreements provide the linked site with certain advantages of quality control and exclusivity.[56] The American Bar Association, Business Law Section, has prepared a draft advertising agreement for the Internet, which covers such aspects as shared resources, conditions of access and use, third-party advertising provisions, security and protocols and compatibility.[57]

Owners of sites who want to prevent linking may resort to a number of techniques to either identify linking sites or to prevent such linking. Web site owners may limit access to image files, permitting only access from an authorized site. A web site owner may prevent a site from being framed by adding instructions to the source code so that when a page is linked a new window opens for that page without the linking site's page frame.

Meta Tags

The technique of "meta tagging" enables Internet advertisers to piggy-back on the content or reputation of other Internet sites by using the trade mark or other key identifiers of those sites. Internet search engines locate and priorize sites using key word identifiers, known as "meta tags". By meta tagging, the identifiers of frequently visited sites are imbedded in the hidden text of another advertiser's site for the purpose of attracting search engine attention to that site.

In the U.S., several challenges have been brought successfully by trade mark owners to stop competing sites from using their marks as meta tags. In one case, a Colorado law firm obtained a permanent injunction preventing a web site design page company from using its name (well-known as cyberlaw experts) as a meta tag.[58] The grounds included unfair competition and trade mark dilution. In another case, Playboy Enterprises obtained a preliminary injunction preventing an advertiser from imbedding in its hidden text the terms "Playboy", "Playboy Magazine" and "Playmate" and also ordered it to change its domain names which at the time were "playboyxxx.com" and "playmatelive.com.".[59]

To date, there are no decided Canadian cases dealing with meta tags. The issues in any such action would likely include whether a trade mark used as a meta tag actually causes "confusion" in the mind of the public, given that it is not visible to the Internet user, and whether a meta tag constitutes a misrepresentation sufficient for a passing off action.[60]

PRIVACY

As noted previously, issues of privacy, including limitations on collection and use of personal information, and protection from unsolicited user-specific targetted marketing, have become a key focus of potential regulation affecting Internet commerce. However, while the Internet has heightened focus on these issues, concerns for protection of privacy extend beyond the information superhighway to all facets of product marketing in today's information-based economy. The collection of personal data and its use to develop profiles of potential customers encompasses mechanisms that range from the "low-tech" simple application form or product warranty registration card to "high-tech" devices such as consumer loyalty and frequent flyer cards using imbedded technology to register particulars of each use. Advertisers are actively seeking ways to collect detailed information about consumers with a view to developing increasingly effective and targetted marketing messages and strategies.

Product marketing in all fields are using today's advanced technology systems to collect, collate and craft uses for data sourced from their customers and others. The motivation is two-fold. In the first instance, advertisers are seeking to become more familiar with their existing customers with a view to enhancing their satisfaction and looking for new ways and new products to market to them. Secondly, advertisers are looking to expand their customer base by targetting in a focused, data-specific way, persons whom they believe will be very interested in receiving information about their products and services.

The Internet provides a particularly powerful vehicle for data collection and use because of the relative ease by which information can be obtained and, once organized and accessed, turned to profitable use.

Internet use allows three potential avenues for information collection: (i) through information actively provided by users when they visit a web site; (ii) by transaction-generated information ("TGI") which is left as a trail (involuntarily) by a user on a visit to a web site; and (iii) by the use of "cookies".

Information Actively Provided by Users

Frequently, visitors to a web site are required, as a condition of navigating the site, or of entering a contest offered by the site, or in connection with making a purchase, to provide personal information about themselves including, in addition to basic identification and billing information (such as name, postal address, telephone number, e-mail address and credit card number), demographic information, purchasing preferences and interests. This information is used to create personal profiles by the advertiser for future targetted marketing and potentially, sale or rental of such information to others. At a more elementary level, web site user data is used to demonstrate traffic levels in order to induce advertisers to buy space on the site and to justify the fees charged.

A particular area of concern for user-provided information focuses on child-oriented sites. The reasons for this concern are that children, presumably, will be less likely to use their discretion to decline to provide information and more likely to indiscrimately navigate a site (and potentially make purchases or enter contests or other promotions). Recent examples of personal information collected on children's advertising sites include web site-based surveys to develop mailing lists and to "micro-target" potential customers. In one case, a candy manufacturer offered free samples of its products to visitors on its site who filled out a survey. In other cases, web sites encouraged children to visit and play with well-known product cartoon "spokescharacters" characters; instances have been reported of children who responded subsequently receiving an e-mail from a "spokescharacter" urging them to return to the site for "more fun".

A recent survey of web sites conducted by the U.S. Federal Trade Commission confirmed that a large number of advertisers are collecting information from visitors, including children. The survey found that 89% of the 212 sites visited collect personal information from children. Just over 50% of those sites provide some form of disclosure of their information practices.[61] However, only 23% of those sites require children to seek parental permission before they provide information to the site, and less than 8% of the sites state that they will notify parents of their information practices. These findings are comparable to those regarding normal commercial web sites. Of the 674 sites included in the survey, 92% were found to collect personal information. Only 14% of these provide any notice regarding their information practices, and only 2% have comprehensive privacy policies.

Transaction-Generated Information

Transaction-generated information resulting from a user's visit to a web site and, potentially, purchases at the site has been characterized as an "electronic footprint"[62] which summarizes the on-line transmission including time and length of visit, number and identity of pages visited, and the user's type of browser and Internet address. This information is, like actively-provided information, able to be retrieved and used to create user profiles. The privacy concern with collection of TGI is that this data may be collected each time an individual surfs the Net with the result, potentially, through aggregation, of creating a detailed picture of the individual and his or her interests, all without that person's knowledge or control.

Cookies

A specific and distinctive form of TGI is represented by "cookies" which are digital files transmitted to and placed on a visiting computer's hard drive by a web browser or host web site. The electronic communications that follow deposit on the cookie information about the user as he or she browses the web site. Then, the next time that the user visits that site, the server which sent the cookie accesses the information stored on the cookie, which allows it to keep up to date on what the user has already viewed on the site. The TGI collected and stored by cookies may be more detailed and refined than that which is simply collected by on-line transmissions, since it will be constantly updated each time a user visits the subject site. Cookies also can be used to expedite entry to sites which require member qualification, by way of storing and providing the data required for access.

Accordingly to some commentators, cookies are a key concern in the realm of Internet privacy because, not only can they be used to collect transmission-related data but, if previously provided on a site visit, they may store other personal information such as telephone number and credit card particulars. Further, as noted above, the quality of personal information stored on a cookie may be high and, once accessed by a remote server, can be aggregated with other information previously obtained to create a very detailed profile of the user.

Concerns about unconsented-to collection and use of Internet-generated personal data are high on the issue agendas of users and regulators alike. However, some commentators argue that the creation of interlinked data bases has benefits. They argue that better, cheaper information may lead to decreased transaction costs "leading to more efficient markets and increased consumer satisfaction" and cite the potential benefits resulting from anticipating consumers' interests and selecting information that may be of interest to them.[63]

Regulatory and Other Responses to Privacy Concerns

In jurisdictions throughout the Internet world privacy concerns are the focus of governmental regulatory and voluntary industry initiatives. Even in the United States, the last redoubt of free communication and an open and unregulated Internet, a number of bills have been introduced in Congress and both public regulatory and private industry bodies have called for controls on collection and use of personal information.[64]

In Canada, the federal government recently introduced Bill C-54, its proposed *Personal Information Protection and Electronic Documents Act*[65] which, when enacted, will lay down rules for requiring knowledge of and consent to the collection of personal information; security and use of such information; and access to such information by the provider including disclosure of third parties to whom the information has been provided. At present, Quebec is the only Canadian jurisdiction that has enacted legislation regulating the collection and use of personal information.[66]

The framework laid down by Bill C-54 substantially follows the *Model Privacy Code* which was adopted as a standard by the Canadian Standards Association in 1996. The *Model Privacy Code* reflects the OECD's *Guidelines on the Protection of Privacy and Transborder Flows of Personal Data*, adopted in 1980. The proposed *Act* will apply to personal information collected and used in any media, but is intended to have particular impact on Internet privacy issues. Of note, e-mail addresses are encompassed within the broad definition of "personal information" laid down by the *Act*. Any advertiser who wishes to obtain and use an individual's e-mail address will be required, before doing so, to follow the *Act's* requirements for disclosure of purpose and obtaining consent. Consequently, the proposed *Act*, if effectively complied with, will limit significantly the potential for unsolicited e-mail (or "spamming") as an Internet marketing technique in Canada.

One of the purposes for Canada's introducing Bill C-54 at this time may be to enable Canadian Internet advertisers to meet minimum standards for personal data use laid down in the European Union's *Directive on the Protection of Individuals with Regard to the Processing of personal Data and on the Free Movement of Such Data* (or "*Data Protection Directive*"). The *Directive*, which becomes effective December 15, 1998, requires member states to pass legislation restricting the transmission of personal information to other member states which have not enacted legislation meeting certain criteria regarding the protection of such information. This restriction also applies to data flows from member countries to countries outside the EU, which would include Canada and the United States. However, it is not clear that, even with the passage of Bill C-54, Canada would comply with the extent of protection and control of data stipulated in the EU *Directive*. Furthermore, at the moment, no such legislation exists in the U.S. It remains to be seen what impact the EU *Directive* will have on Internet advertising and marketing practices worldwide, particularly in light of the fact that 80% of Internet commerce emanates from the U.S.

ENFORCEMENT ISSUES

Among the most difficult issues facing Internet advertisers and regulators alike relate to jurisdiction and liability. These issues have not been adequately addressed by the current legislative rules or received any serious consideration in Canadian courts. Both of these issues impact on the effectiveness of the enforcement capabilities of regulatory bodies.

Jurisdiction

Since works on the Internet can be sent to, or accessed by, multiple users simultaneously across several international boundaries, in private, and with the relative ease of the push of the button, the jurisdiction of any government regulatory body or court in which an action is brought is very much an issue. The very nature of the communication is that it has no physical or spatial boundary. This raises the question of where the allegedly infringing or non-complying act takes place and which country's laws apply. For instance, which country has jurisdiction when a work is telecommunicated from a computer in country A, downloaded in country B, and the host server is in country C? Each geographic/legal jurisdiction (e.g. province, state, country, free trade group) has its own sets of laws and procedures in which it has a legitimate interest in enforcing against what it regards as infringing or illegal acts, whether of subscribers or service providers. When the laws in each jurisdiction differ, compliance becomes more onerous for the advertiser. The question is: when does an advertiser become subject to the laws of a jurisdiction?

In Canada, to date, there has been little formal regulatory activity or private litigation involving Internet advertising. The Competition Bureau has succeeded in prosecuting one company in connection with a multi-level marketing scheme advertised on the Internet[67] and has begun to monitor Internet advertising.[68] However, the U.S. state and federal regulatory bodies have been active in commencing proceedings against Internet advertisers;[69] as well, private litigation involving advertisers and others has become more frequent with the increase in commerce on the Net. In Canada, the issue of jurisdiction over Internet advertising has been raised directly in only one case,[70] in a web site. In that case, a contempt order was made by the Federal Court for breach of a previous injunction respecting trade mark infringement, a web site entitled "Canadian Yellow Pages on the Internet", loaded onto a server located in Nevada and operated by certain U.S. companies. The issue of jurisdiction has been raised in a number of U.S. cases, which may provide guidance to Canadian courts.

The basic rule of jurisdiction in Canada in both criminal and civil matters is that a "substantial connection" must exist between the proposed defendant or cause of action and the forum in which the action is proposed to be brought.

Generally speaking, a state has criminal or regulatory jurisdiction over actions occurring within its legal boundaries if the subject acts occur or have substantial effects within those boundaries. In Canada, subsection 6(1) of the *Criminal Code* directs that, subject to any other federal statutory provision, no person shall be convicted of a criminal offence committed outside of Canada. While this provision might appear at first blush to have an *exclusive* rather an *inclusive* effect, Canadian courts have not hesitated to take jurisdiction where the victim and hence the impact of an illegal act resided outside of Canada. It is clear now that all that is required to make an offence subject to Canadian regulatory jurisdiction is for a significant portion of the activities constituting the offence to take place in Canada, irrespective of whether actions originate, or alternatively have their ultimate impact, outside of Canada.

Recent authority for such criminal jurisdiction in transnational activities is found in the 1985 Supreme Court of Canada decision in *Libman v. The Queen*.[71] There, accused operated a "boiler room" for telephone solicitation of fraudulent securities sales to U.S. residents. The boiler room was located in Canada, where the misrepresentations were made; the targets of the solicitations lived in the United States and purchase funds were directed to bank accounts in either Panama or Nassau. In agreeing that Canadian law had jurisdiction, and therefore implicitly that an offence took place in Canada, Mr. Justice La Forest posited the relevant criteria as follows:

> I might summarize my approach to the limits of territoriality in this way. As I see it, all that is necessary to make an offence subject to the jurisdiction of our courts is that a significant portion of the activities constituting that offence took place in Canada. As it is put by modern academics, it is sufficient that there be a "real and substantial link" between an offence and this country, a test well known in public and private international law." [72]

As mentioned, the issue of jurisdiction over Internet activity has been addressed by the American courts. However as is often the case, different state courts have rendered inconsistent decisions. In terms of personal jurisdiction in civil actions, a U.S. court must first determine that the defendant by its actions has "purposefully availed" itself of the protection and benefits provided by the forum state. Once this has been established, the court must also be satisfied that its taking jurisdiction does not offend traditional notions of fair play and substantial justice. This analysis, which is based on the due process clauses in both the United States and individual state constitutions, requires that the non-resident defendant have had sufficient "minimum contacts" of a quality and nature that it is fair, just and reasonable to require it to defend an action in the forum state.[73] As well, specific authority for jurisdiction over non-resident defendants must be found in each state's so-called "Long Arm Statute", which lays down the conditions for such jurisdiction.[74]

In *Maritz v. Cybergold Inc.*,[75] the plaintiff alleged trade mark infringement under the *Lanham Act*.[76] At issue was whether the court possessed personal jurisdiction over the defendant. Cybergold, which was located in California, maintained an Internet site on the World Wide Web which was continually accessible to every Internet-connected computer in Missouri and the world. It advertised a service for compiling electronic mailing lists. Apart from Internet access, Cybergold had no contacts with Missouri. The plaintiff alleged that Cybergold had actively solicited customers in the state.

The court held that the defendant's contacts with Missouri were sufficient to establish jurisdiction. It concluded that the "defendant Cybergold, through its Internet activities, has purposefully availed itself of the privilege of doing business with this forum such that it could reasonably anticipate the possibility of being hailed into court here". The court characterized the web site as an "active" contact rather than a "passive" advertisement ranking it on a higher level than direct mail or promotions using "1-800" numbers within the state[77]. In essence, the court refused to shield a defendant on the basis of the expanse of the Internet when that person derived benefits precisely because of this characteristic.

In another case,[78] also involving trademark infringement, a Connecticut federal court found jurisdiction over a Massachusetts-based Internet advertiser which had no offices or employees in Connecticut and did not carry on business there. The court held that Internet advertising constituted “repeated” solicitation of business in Connecticut sufficient to meet the requirement of the state’s long-arm jurisdiction statute.

These and other U.S. cases suggest that the threshold for establishing jurisdiction over Internet advertisers with few, if any, specific connections with a state is low indeed. However, other state courts have differed, evidencing the requirement of a higher threshold to establish jurisdiction.

In *Bensusan Restaurant Corp. v. King*,[79] another trademark infringement action, a New York court focused on the actual use or intent to sell the subject product (tickets to a night club in Missouri) in the state. In this case, the defendant King resided in Missouri and operated a small club there called the Blue Note. Bensusan operates a jazz club in New York City also called the Blue Note and owns the federally registered mark, “The Blue Note”. In April 1996, King posted a site on the Web to promote ticket sales for his club. On that web site he placed the following disclaimer:

> The Blue Note’s Cyberspot should not be confused with one of the world’s finest jazz clubs the Blue Note, located in the heart of New York’s Greenwich Village. If you should find yourself in the Big Apple give them a visit.

Furthermore, the reference to the club in the disclaimer contained a hyperlink which permitted users to connect directly to the New York club’s site.

The court, in declining to find jurisdiction, drew attention to the “affirmative steps” required of New York residents to obtain information about and ultimately to purchase tickets for the Missouri club, including:

(a) accessing the web site through his or her own computer;
(b) telephoning the ticket office in Missouri; and
(c) travelling to Missouri to pick up the tickets.

The court concluded that any such sale took place in Missouri and that there was no evidence that any infringing goods were shipped to New York or that any other infringing activity was a directed at the New York club.

In contrast to the Maritz case, the court concluded that although a user in New York could gain information on the Missouri club from accessing the web site, that was not equivalent to advertising, promoting or selling the product in New York. Furthermore, the court held that a web site does not itself constitute a contact with a remote jurisdiction sufficient to permit a court to find that the advertiser had purposefully availed itself of the benefits of doing business in that jurisdiction. The court declined to accept the plaintiff’s argument that the advertiser should have foreseen that the site would be viewed in New York and therefore should have taken steps to restrict his site to users in a specific geographic region.

In another case of trademark infringement, *CompuServe Inc. v. Patterson*,[80] an Ohio federal court posited three criteria to determine whether it could exercise jurisdiction over an outofstate party, based solely on Internet activity:

(a) the party must purposefully avail itself of the privilege of acting in the legal entity claiming jurisdiction, or causing a consequence in that entity;

(b) the cause of action must arise from the party's activities in that entity; and

(c) the acts of the party or their consequences must have a substantial connection with the entity to make the exercise of jurisdiction reasonable.

This test suggests a more stringent standard for acceptance of jurisdiction than that articulated in the *Maritz* case and one more consistent with the conclusions of the court in *Bensusan*. In the *CompuServe* case, the defendant (who resided in Texas) marketed his software products over the CompuServe system; however, the court concluded that this act along was insufficient to establish jurisdiction. The court looked to the agreements entered into (electronically) between the defendant and CompuServe (which is based in Ohio) for the purpose of allowing the latter to use CompuServe's system; in addition, it looked to the fact that the defendant's computer files were stored with CompuServe in Ohio. The court determined that it had jurisdiction to hear Compu- Serve's motion for a declaration that it was not infringing the defendant's trademarks.[81]

The central issue that is posed by these U.S. cases is whether a non-resident advertiser simply by posting a web site on the Internet satisfies the "purposeful availment" requirement for jurisdiction. Clearly some courts in the U.S. think so. However, to suggest that Internet advertising on a web site represents more active and purposeful contact than direct mail or magazine advertising is subject of some debate.[82] The better view is that some physical presence by the advertiser (place of business, originating computer or server; use of local ISP), active soliciting of customers, or contractual contacts with persons in the state is required to render it subject to a state's jurisdiction.

In a New York case, the efforts of state attorneys general to combat consumer fraud on the Internet was tested for jurisdictional viability.[83] In that case, the defendant sold magazine subscriptions over the Internet from a location in Staten Island, New York. He created fictitious messages from allegedly satisfied customers extolling the low prices and customer service provided by his service. These "chatty and friendly" messages were sent by e-mail to members of particular chat lines. The fictitious author was portrayed as a member of the group. However, attempts to trace the author indicated that the name source was non-existent.

Customers who subscribed for the magazines complained to the New York attorney general that they arrived late or not at all and, if they did, were for shorter periods than ordered. The defendant was alleged to have retaliated against complaining customers by sending multiple copies of the complaints to other chat group members. The attorney general charged the defendant with deceptive acts and false advertising under the state's *General Business Law*. [84]

The court rejected the defendant's argument that neither the attorney general nor the court had jurisdiction. It held that the defendant, by being a subscriber to a local Internet service provider and selling products through that provider, had brought itself within the jurisdiction of New York law (citing *CompuServe v. Patterson*). Further, the defendant was physically located in New York. Having determined that the defendant met the "purposeful availment" test, the court also concluded that he had met the minimum contacts (due process) requirement since the defendant's acts had occurred within the jurisdiction.

In response to the defendant's thesis that the Internet is somehow "off limits" for state (or any jurisdiction-based) regulators, the court stated:

> ...for Internet consumer fraud claims, the Internet medium is essentially irrelevant, for the focus is primarily upon the location of the messenger and whether messenger delivered what was purchased. ...[T]he state attorney general has clear authority to restrain illegal business practices by a local business in relation to both in-state and out-of-state residents, notwithstanding that these practices occur on the Internet.[85]

The *Lipsitz* case is consistent with the Supreme Court of Canada's decision in *Libman* and we may conclude that a similar result should be achieved in the case of fraudulent Internet advertisers using Canada as a base.

Based on our understanding of the general rules of jurisdiction as applied to various forms of advertising and taking guidance from the cases, we can posit several propositions for the application of Canadian legal jurisdiction to Internet advertising.

Generally speaking, a state will exercise regulatory jurisdiction over acts that occur or have substantial effects within its legal boundaries. Therefore, an advertisement that is published, broadcast or otherwise disseminated to the public at large from a source within a geographic/legal entity will be subject to its regulatory jurisdiction. Furthermore, specifically-addressed advertising such as direct mail and telemarketing, whether originating within or outside of the entity, will be subject to its regulatory jurisdiction, although enforcement may be problematic in the case of communications sourced from beyond the entity's borders.

In the case of Internet advertising, it is likely that any advertising originating or downloaded/uploaded onto systems physically located within the entity's geographic boundaries will be subject to its regulatory jurisdiction. Furthermore, the likelihood of regulatory enforcement measures is enhanced by the physical presence of persons or physical property within the entity. Advertising carried over the Internet and received by computers within, but otherwise having no connection to the entity is more difficult to analyze. An analogy with spillover or transborder television advertising may be useful. Clearly, advertising carried by television stations in the U.S. that is not intended by its content to influence or impact persons in Canada should not be of regulatory concern to Canadian authorities, even if it is received in Canada. On the other hand, advertising that is directed to Canadian residents would be of concern. However, unless the regulators can point to an act or physical action relating to such advertising within Canada it may be difficult to establish Canadian jurisdiction. Therefore, if the television advertising were carried over a Canadian cable system, or the advertiser had a physical presence in Canada, or specific resulting sales by the advertiser take place within Canada, jurisdiction is likely to be established.

A similar analysis could be made of nonCanadian source advertising over the Internet. If the advertising is clearly *not* directed at Canadian residents, then Canada should have no regulatory jurisdiction, even though it may be accessed through physical systems located within the country. On the other hand, advertising clearly directed at Canadian residents should be subject to Canadian regulatory jurisdiction. Whether or not any effective enforcement can be achieved is a separate matter.

The more difficult question, however, is the extent of a country's regulatory jurisdiction over foreignsourced Internet advertising which is not clearly directed at - or not at - its residents. The advertising may be communicated over facilities (service providers, common carriers, computers) located within the country; to enhance the argument for jurisdiction one would only have to identify "hits" or "logons" from computers physically located in the country. Such advertising is potentially subject to regulation by any country or other geographic/legal entity in which Internet connections accessing it exist. To date, however, we have little judicial (or legislative) guidance as to the right of regulators in this country to exercise jurisdiction over advertising solely on the basis that is available over the Web. As noted above, the U.S. cases are not conclusive on this issue, although clearly certain courts would be prepared to recognize this as a basis for jurisdiction.

Liability for Advertisers

Assuming there is legal jurisdiction over on-line entities against whom proceedings are brought, the second question is, "who is liable?". When it comes to Internet advertising and other on-line commercial disseminations of information, the answer may be simple or complex depending on the role played or activities performed by the on-line entity. On the Internet, liability may extend not only to the person sourcing the advertising (such as a manufacturer of a product if it has created and initially published the advertising claim), but also to each on-line entity through which that advertising is ultimately communicated to the consumer. The range of potentially liable parties include, apart from the specific product advertiser, other web sites (which may carry advertising for the product or links to another web site), cyber malls carrying advertising for a range of products (or simply containing links to product-specific Web pages), search engine pages and bulletin boards.

Most of these on-line entities can be analogized to traditional media which under our laws are generally treated as responsible for advertising messages carried by them. However, can the same characterization be made for ISP's such as America Online and CompuServe or local service providers? ISP's are the interface between a user and the Internet and may be the only intermediary which can be readily identified. For these reasons, they are being characterized as equivalent to publishers and broadcasters.[86] Therefore, liability may extend to them as well. However, it has been argued that a distinction should be drawn between on-line parties who actively create or present advertising material and those which simply supply the communications interface.[87]

Two U.S. cases which have addressed the issue of liability of ISP's indicate that the degree of control over content may be the key determinant. In *Cubby v. CompuServe*,[88] the court concluded that CompuServe, which operated a closed proprietary network, was not responsible for libel alleged to have been contained in a news letter posted on one of its bulletin boards. The court characterized the ISP as an "electronic not-for-profit library which did not have either the opportunity or the means to scrutinize the content of material carried by it". In another case, [89] the court found the ISP liable for defamation for materials carried on its closed network since it had attempted to filter content and therefore did not act only as a conduit. In that case, the court held that the ISP was a "publisher" which had the power to review, edit and delete messages posted on its bulletin board that could be considered defamatory. In response to this latter case, the U.S. has enacted legislation to provide that providers and users of "interactive computer services" are not to be treated as publishers or speakers of information provided by another person.[90] The success of this attempt to protect ISP's from liability may be limited to the liability which may arise from being deemed a publisher or speaker of illegal material or being based solely on efforts to limit access to such material. Where the ISP's conduct goes beyond such activities and constitutes knowledge of and participation in the impugned activity, the protection does not appear to apply.[91]

The prohibitions against false or misleading advertising contained in the *Competition Act*, as discussed previously, apply to any person who makes a representation to the public for the purpose of promoting a product or a business interest. This prohibition is extended by the *Criminal Code* [92] to anyone who aids or abets the commission of an offence. Traditional media entities are subject to this prohibition and by analogy on-line entities responsible for communicating advertising to consumers are likely similarly liable. However, the statute recognizes a lesser burden of compliance for media in certain cases which may have application to Internet advertising.

The *Competition Act* contains, in subsection 60(1), a specific exclusion that may address the liability exposure of certain on-line entities. Essentially, a person who accepts "in good faith" an advertisement for distribution in the ordinary course of his or her business, on behalf of another person in Canada, is not liable for breach of any of the misleading advertising prohibitions under the Act. This exclusion, while originally intended to apply to the traditional print and broadcast media, should be broad enough to cover Internet on-line entities who accept or pass on advertising sourced from a third party.

To qualify for the exclusion in subsection 60(1), the on-line entity must meet three pre-conditions:

(a) The advertisement must be carried *on behalf of another person*; in other words, the on-line carrier cannot be the advertiser, but only the medium of communication; therefore an on-line entity (e.g. a shopping mall) which carries an advertisement for a product and receives some portion of the purchase price of the product (e.g. a commission) would not qualify.

(b) The advertisement must be carried in *good faith*; in other words, the on-line carrier must have accepted the message without knowledge or suspicion of any non-compliance with the statute.

(c) The person (i.e. the source) on whose behalf the advertisement is carried must be "*in Canada*"; therefore any on-line entity which carries advertising sourced outside of Canada cannot avail itself of the exclusion.

Whether or not the exclusion will apply will depend on the circumstances in each case. Of course if the on-line party's due diligence reveals that the subject advertising does not comply with the law, it will not be able to avail itself of the protection. Furthermore, on-line entities operating in Canada may not easily be able to identify whether the source of the advertising is within Canada or not. Many such entities may carry various advertising messages originating both within and outside of Canada.

Approach to Compliance for Internet Advertisers

The foregoing analysis of jurisdiction and liability issues suggests that a conservative approach to compliance for Internet advertisers and other on-line entities would include the following:

(a) Firstly, determine in what national or other legal jurisdictions advertising messages are intended to be received;

(b) Secondly, confirm compliance with applicable regulatory rules in all such jurisdictions;

(c) Thirdly and once appropriatelycomplying advertising has been written, clearly indicate in the advertisement or on the advertiser's "legal page", the jurisdictions to which the messages are directed.

(d) Finally, if the advertisement contains a promotional offer, contest or solicitation of product sales, stipulate a governing law and forum (i.e. court jurisdiction) for any disputes.

On-line entities other than the originating advertiser may also be liable for legal compliance of the messages they carry and therefore need to determine the level of due diligence required of them. On-line entities carrying Canadian-sourced advertising may be able to benefit from the publishers exemption if they meet the statutory conditions. Those should be carefully reviewed based on the factual circumstances.

Enforcement Initiatives

Even if jurisdiction exists, significant enforcement difficulties are faced by regulators in a national or other legal entity vis-a-vis Internet advertising that has no physical connection within the entity's boundaries. However, efforts at international mutual assistance among regulatory authorities have borne fruit and are likely to grow. In 1995 Canada and the United States entered into an agreement for mutual cooperation and assistance of their competition and marketing practices laws.[93] This agreement has provided a framework for cooperation between the Competition Bureau and the Federal Trade Commission. In March, 1996, the

Bureau and the FTC signed an agreement establishing a Canadian-U.S. Task Force on Cross-Border Deceptive Marketing Practices. The goal of this Task Force is to provide a framework for co-operation among law enforcement bodies in each country to address deceptive marketing practices that have cross-border elements. As evidence of the Task Force's work, last year members of the Bureau, the FTC and law enforcement agencies in Canada and the U.S. undertook a co-ordinated "sweep" through Internet sites and user groups to identify advertisements for "business opportunities" which could raise issues under the countries' respective legislation.[94]

The Bureau is also active in the International Marketing Supervision Network, an informal forum of OECD member countries that meets regularly to exchange information in relation to unfair marketing practices worldwide. A recent meeting of the IMSN dealt with on-line fraud.[95]

FUTURE REGULATION OF INTERNET ADVERTISING

To date, governments in North America have not rushed headlong into legislative regulation of the Internet. However, the past year has seen a significant number of proposals for legislative intervention and rule-setting that, if enacted, will impact on Internet advertising. The most significant of these initiatives from a Canadian perspective is Bill C-54.[96] In the U.S. there have been a number of legislative initiatives at both the federal and state level addressing protection of children from Internet pornography, privacy and measures to counter spamming, or junk e-mail.

Net-specific approaches to content regulation aside, as we have seen, significant challenges may exist to effective national- or legal unit-based jurisdiction over any enforcement of Internet advertising. Furthermore, existing content rules apply with full vigour to Net advertising and therefore certain assurance can be taken that claims and promotions which do not comply with current rules applicable to all advertising will be addressed. The U.S. experience shows that these remedies can be resorted to effectively. However it is clear that techniques of using the new technology to advertise, promote, reach subscribers and to develop consumer data for future marketing are actively evolving. Governments as well as the Internet community are increasingly seeing the need for selective intervention or the development voluntary industry codes in order to ensure that Internet commerce can grow in a fair environment that protects reasonably the interests of all users.

While governments recognize that there will be need for some form of regulation of Internet commerce, there appears to be a strong inclination to marry any legislated rules with a framework of industry self-regulation. There are several reasons to recommend such an approach. In the first place, a strong sentiment prevails among the Internet community that it is best positioned to identify and correct harmful aspects of Internet commerce. This sentiment emanates from the grass-roots philosophy that characterizes Net culture.

An interesting example of self-regulation, reflective of this individualist philosophy, can be found in a new variation of the time-worn "correction notice", so often seen in daily newspapers. However in this case it is other Netizens, not the advertiser, who publish the notices by posting complaints of alleged misleading advertising on bulletin boards on the Net. A more formalized approach exists in the form of a "Blacklist of Internet Advertisers" whose purpose is to curb inappropriate advertising on Usenet newsgroups and junk e-mail.

While the individual policing approach may not hold the complete answer to effective self-regulation, drawing upon the resources of service providers and users to assess the areas needing regulation and to draw up appropriate rules has a number of advantages. Those best able to understand the technology and its potential for misuse would contribute to the creation of rules. One would look for a flexibility in approach and a readiness to evolve to meet new issues, both precepts which should be possible to have in a user-based self-regulatory approach. In the U.S. proposed legislation currently before Congress would, instead of imposing statutory rules for privacy protection, establish industry working groups to draw up voluntary guidelines dealing with: protection of personal information; prohibiting spamming and unsolicited commercial e-mail; and providing mechanics and incentives for compliance with the guidelines.[97]

A further important potential advantage of a user/provider-based self-regulatory framework would be effective enforcement. As discussed above, jurisdiction and enforcement of statute-based rules pose certain issues in the context of Internet advertising regulation. However, an international framework for advertising compliance based on agreement or a more structured framework (e.g. industry association) among key Internet service providers and advertisers, world-wide, could be very effective in enforcing a code of conduct. One could envisage a complaint-resolution bureau, similar to that provided by Advertising Standards Canada, as the first level of remedy, with an adjudication function at a second level. Finally, enforcement could be achieved by all media members (e.g. service providers, access bureaus and search engines) refusing to carry any further advertising by the offender until remedy is made. Given the international reach of service providers such as America Online, this type of enforcement mechanism could have great international leverage, and should achieve a substantially effective sanction, even in the absence of universal adherence to the self-regulatory mechanism.

In sum, the Internet is creating a whole new focus for advertising compliance. Existing, established rules governing advertising compliance constitute a framework for regulation of commerce on the Internet; however additional rules may be required as the system and its full potential develops. While specific legislation may ultimately be necessary, self-regulation of Internet advertising appears to hold great promise. This paper has sought to review the sources of the main regulatory rules for Internet advertising as well emerging issues and potential constraints under intellectual property law. Issues relating to jurisdiction and enforcement as well as future regulation are addressed.

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1 Sept. 29, 1998.

2 However advertising, such as appears automatically on search engine and web site pages, is not selected by the viewer specifically but by the user selecting the particular search engine program.

3 Peter Bartlett and Matthew Deeble, "When Push Comes to Pull - The Legal Implications of Publishing on the Internet", Australia Transport and Regional Development Home Page @ dot.gov.au.

4 Re Misleading Advertising??? (11/23/96) by johnlinch@aol.com.

5 See for example: The Canadian Direct Marketing Association's *Code of Ethics and Standards of Practice*; in the U.S., the *Consumer Anti-Slamming Act* (H.R.3888) and *Unsolicited Electronic Mail Choice Act*

(H.R.5771); of note also is Bill C-54, Canada's proposed *Personal Information Protection and Electronic Documents Act*, which would protect the privacy of e-mail addresses.

6 See Ron Urbach, "Advertising in Cyberspace: New Challenges and Problems in the Electronic Age", paper presented to The Canadian Institute Conference, "Advertising in Cyberspace: New Challenges and Problems in the Electronic Age", June 2, 1997.

7 *Ibid*.

8 S.C. 1991, Chap. 11, ss 1-10.

9 R.S.Q. 1980, Chap. P-40.1, ss 248 and 249; Application Guide for Sections 248 and 249 (Advertising Intended for Children Under 13 Years of Age) (Office de la protection du consommateur, 1980).

10 *Broadcast Code for Advertising to Children* (Canadian Association of Broadcasters, 1988); *CAB Code of Ethics* (Canadian Association of Broadcasters, 1989), clause 3; *CBC Advertising Standards* (Canadian Broadcasting Corporation, 1993) Section B.

11 R.S.C. 1985, Chap. C-34, subs. 52(1).

12 R.S.C. 1985, Chap. F-27, s. 5(1).

13 R.S.C. 1985, Chap. T-13, s. 7.

14 R.S.C. 1985, Chap. C-38.

15 R.S.C. 1985, Chap. H-3.

16 R.S.C. 1985, Chap. T-10.

17 R.S.C. 1985, Chap. 14 (4th Supp.), s. 4.

18 For example, the Ontario Business Practices Act, R.S.O. 1990, Chap. B.18.

19 *Liquor License Act*, R.S.O. 1990, Chap. L-19, s.38

20 *Motor Vehicle Dealers Act*, R.S.O. 1990, Chap. M.42, s. 19.

21 *Oleomargarine Act*, R.S.O. 1990, Chap. 0.5.

22 *An Act Respecting Lotteries*, *Publicity Contests and Amusement Machines*, R.S.Q. 1980, Chap. L-6; *An Act Respecting the Régie des alcools*, *des courses et des jeux and amending various legislative Provisions*, L.Q. 1993, Chap. 39; *Rules Respecting Publicity Contests*, R.R.Q. 1981, Chap. L-6, s. 20.

23 S.C. 1993, Chap. 38.

24 See Bill C-20, *An Act to Amend the Competition Act and Another Act in Consequence*; first reading, Nov. 20, 1997; second reading, March 17, 1998; s. 13 (adding section 52.1 to the Competition Act).

25 *Proposed Rules*, *Federal Trade Commission, Interpretation of Rules and Guides for Electronic Media; Request for Comment*, 63 FR24996, 24997 (May 6, 1998).

26 *Ibid*.

27 Proposed new section 52.1. Potential penalties include unlimited fines and imprisonment of up to 5 years.

28 See "Telemarketing fraud targeted", *Globe & Mail Report on Business*, July 19, 1997 at p. 135 and Rachel Larabie-LeSieur, "The Competition Bureau's Marketing Practices Branch: Enforcement Priorities and Hotspots" paper presented to The Canadian Institute Conference, "Legal, Practical and Tactical Advertising", June 2, 1997.

29 16 C.F.R. Part 310

30 See *R v. Saro's Ltd.* (1978), 40 C.P.R. (2d) 208 (Ont. Prov. Ct.); *R. v. The Cameo Sleep Shop Ltd.* (Ont. Prov. Ct.) March 11, 1996; *Misleading Advertising Bulletin*, Director of Investigation and Research, Jul. Dec. 1990, Consumer and Corporate Affairs Canada, pp.3-6.

31 *R. v. International Vacations Ltd.* (1980) 56 C.P.R. (2d) 251 (Ont. C.A.); *R. v. Intra-Canada Telecommunications Ltd.* (Ont. Co. Ct.) March 16, 1984; *Purolator Courier Ltd. v. United Parcel Service Canada Ltd.* (1995), 60 C.P.R. (3d) 473 Ont. Gen. Div.); *R. v. Pepsi-Cola Canada Ltd.* (1991), 40 C.P.R. (3d) 242.

32 See John W. Scriver, "Surf 'N Win: Conducting Effective (and Legal) Contests on the Web, paper presented to Canadian Institute Conference, "NetLaw 97", April 14-15, 1997 and Linda A. Goldstein, "New Issues, Cases & Strategies in Online Advertising, Marketing & Promotion", paper presented to PMAA Law/Marketing Conference, November 18-19, 1997.

33 Under the *Criminal Code*, sections 206(1)(a)-(f), a contest is illegal unless (i) there is no purchase required to enter or (ii) prizes are awarded solely on the basis of true skill, as opposed to random selection. While Canadian contests run in traditional media typically provide both a "no-purchase" entry and a "skill-testing

question" (in other words, addressing both qualifying under the *Code*), some Internet contests require significant skill elements such as essay-writing. However due to the idiosyncrasies of the Code, it is not clear that a contest which has elements of both skill and random selection is permitted unless no purchase entry is allowed.

34 839 F Supp. 1552 (M.D. Fla., 1993).

35 Similarly, in *Sega Enterprises Limited v. Maphia*, (1994) 30 U.S.P.Q. (2d) 1921, the court granted a preliminary injunction to prevent bulletin board services and a bulletin board operator from posting programs extracted from Sega video game cartridges. The court found that the defendants were liable for contributory infringement because there was copying each time the games uploaded onto the bulletin board or downloaded from it.

36 Information Highway Advisory Council; Subcommittee on Copyright, "Copyright and The Information Highway" (Ottawa: March, 1995).

37 (H.R.2281); passed by the Congress and expected become law by the end of 1998.

38 Lynda Russell, "Regulating Cyberspace: What are the rules for the info highway?" (1994) 14 *The Lawyers Weekly* No. 24.

39 See Network Solutions' Domain Name Dispute Policy at http://rs.internic.net/dispute.html.

40 NSI's monopoly had been challenged in a lawsuit commenced last fall; however in a decision released in April, 1998, the court upheld NSI's role; *Thomas et al v. National Science Foundation and Network Solutions Inc.* (U.S. Dist. Ct. - D. Columbia) (April 4, 1998).

41 "Genuine Top Level Domain Memorandum of Understanding", February 1997.

42 National Telecommunications and Information Administration, "Improvement of Technical Management of Internet Names and Addresses", Jan. 30, 1997, and "Management of Internet Names and Addresses", June 5, 1998, at http://www.ntia.doc.gov.

43 For a status report on the deliberations to establish a new domain name governing body and the issues relating to future domain name rights and obligations see: Jonathan E. Moskin, "Domain Name 'reforms' will Inflame Internet Problems", *Law Journal EXTRA!*, July/August, 1998 at www.ljx.com/internet/0708-domain.html and Brenda Sandburg, "The Future of Domain Name Governance", IP Magazine, Sept. 23, 1998 @ html://www.ipmag.com/dailies/980923.html.

44 The use by another person of an advertiser's trade mark in a domain name registered by that person may or may not be trade mark infringement. If the trade mark is registered and is used in connection with services provided by the advertiser, use of the name (such as in a domain name) by another person in advertising similar services will be infringement. However, if the trade mark identifies goods of the advertiser (owner), simple use in advertising may not be infringement. Under the *Trade-Marks Act*, "use" in connection with goods requires that a mark be displayed on the allegedly infringing products.

45 1996 U.S. Dist. LEXIS 7160.

46 *Ibid*.

47 (1995) 61 C.P.R. (3d) 334 (P.E.I.S.C.).

48 This result is interesting since domain names do not distinguish between upper and lower case. As well, note should be made of the court's criticism of the plaintiff's lack of explanation of the workings of the Internet. The court suggested that the plaintiff had only made superficial submissions without explaining the Internet system:

> The whole area of the use of the Internet network and its conventions is new to the Court. I find that the plaintiff has only made superficial submissions without explaining the Internet system. The plaintiff merely filed a short affidavit of its president, which leaves much to be desired insofar as an explanation of Internet is concerned. (Ibid at p.338).

49 See *ITV Technologies Inc. v. WIC Television Ltd.*, (1997) 77 C.P.R. (3d) 486, (F.C.T.D.).

50 Sally M. Abel and Lorraine L. Ellerbach, "Trade-mark Issues in Cyperspace; The Brave New Frontier " at Lttp://www.fenwick.com/pub/cyber.html

51 *The Shetland Times Ltd. v. Wills*, (1996) 1 EIPLR 723, (Scot. Sess.).

52 The case has been settled by an agreement allowing the *News* to link stories to the Times' web site provided that each link to a story is acknowledged by a sub-heading reading "A Shetland Times Story" in the same size as the *News'* headline, together with a button showing the *Times'* logo, both the sub-heading and the button enabling a user to click on them and link to the online headline page in the *Times'* web site.

53 *Ticketmaster Corp. v. Microsoft Corp.*, No. 97-3055 DDP (C.D. Cal. filed April 27, 1997).

54 *Washington Post Co. v. Total News Inc.*, 97 Civ 1190 (SDNY, filed 2/20/97)

55 *Supra*, note 12.

56 Steven M. Weinberg, Cyberjinks: Trademark Hijinks In Cyberspace through Hyperlinking and Metatags. Volume 87 of the Trademark Reporter.

57 A.B.A.'s draft advertising agreement can be accessed at : http://www.abanet.org/buslaw/cyber/weblink.html.

58 *Oppedahl & Larson v. Advanced Concepts* et al, Col. Action No. 97-Z-1592.

59 *Playboy Enterprises, Inc. v. Calvin Designer Label* et al, U.S. Distr. Ct, N.D. Cal., Action No. 97-3204 CAL. See also *Instituform Technologies Inc. et al v. National EnviroTech Group, LLC et al*, U.S. Distr. Ct., E.D. La., Action No. 97-2064 (competing advertiser ordered to remove from key word section of its web site plaintiff's registered trade marks).

60 For a discussion see Stephanie Chong, "Internet Meta-tags and Trade Mark Issues", [1998] *European Intellectual Property Review*, Issue 20:7.

61 "FTC Releases Report on Consumers' Online Privacy" June 4, 1998; see www.ftc.gov/opa/9806/privacy2.htm.

62 J. Sessler, "Computer Cookie Control; Transaction Generated Information and Privacy Regulation on the Internet" (1997) 5 J.L. & Pol. 627 (Lexis).

63 M. Froomkin, "Regulation and Computing and Information Technology: Flood Control on the Information Ocean" (1996) 15 J.L. & Com. 395 (Lexis).

64 See: *Data Privacy Act of 1997* (HR2368); *Practice What You Preach Privacy Protection and Promotion Act* (HR4632); *Communications Privacy and Consumer Empowerment Act* (HR1964); see in particular, the *Children's On-line Privacy Protection Act* (S-2326) which would mandate the FTC to stipulate rules for collection of information from and about children through web sites and for greater parental control over the collection and use of such information.

65 October 1, 1998; has now received Second Reading.

66 *An Act respecting the protection of personal information in the private sector*; S.Q. 1993, Chap. 17.

67 *R. v. The Integrity Group (Canada) Inc.* (Alta Q.B.), December 16, 1997.

68 See Rachel Larabie-LeSieur, "Misleading Advertising on the Internet: Competition Law Enforcement in the Electronic Marketplace", speech by the Deputy Director of Investigation and Research (Marketing Practices) to Canadian Corporate Shareholder Services Association conference, "Fraud on the Internet", September 19, 1996.

69 The Federal Trade Commission has brought several cases against on-line advertisers, charging them with making false or unsubstantiated advertising claims. These prosecutions of on-line marketing schemes included illegal credit record repair schemes, fraudulent pyramid schemes and a computer equipment scam. In *FTC v. U.S. Telemedia, Inc.*, FTC, Civil Action No. 96C 1440, the defendant marketed and sold computer equipment, and advertised through America Online. Complaints were received that consumers did not receive items they ordered and were, in situations where they did receive it, unable to obtain refunds on request. In *Massachusetts v. Margorie Phillips*, (Mass. Sup. Ct.), April 2, 1996, the state's Attorney General brought an action against an Internet advertiser alleging unfair and deceptive acts and practices in violation of the *Consumer Protection Act*. The defendant's web site provided medical information and advertised treatments to cure HIV, which claims were false. Recently, the FTC initiated charges against three of the largest U.S. ISP's for failing to disclose that on-line charges would be incurred by consumers who accepted "free trial" offers of on-line services unless the consumers affirmatively cancelled their memberships during the trial period (American Online Inc. (FTC File No. 952-3331); *CompuServe, Inc.* (FTC File No. 962-3096); *Prodigy Services Corporations* (FTC File No. 952-3332). The charges also included failure to disclose extra charges and allegations of unauthorized electronic debiting of consumers bank accounts. The FTC has proposed consent agreements with the ISP's which would include requiring clear disclosure of the terms of any free offer and the terms of all mandatory charges, to obtain prior written authorization for any electronic fund transfers and in one case to establish a consumer education program regarding electronic payment systems. For a discussion, see Deborah K. Owen, "Regulatory Issues Associated with Advertising and Selling Online", in *Advertising and Selling Online,* Glasser Legalworks Seminar, June 16, 1997.

70 *Tele-Direct (Publications) Inc. v. Canadian Business Online Inc. et al* (Federal Court), September 15, 1998. See also *Ernst Zundel v. A-G Canada et al* (Federal Court), September 22, 1998 (web site operated by person in California where server located carrying material authored by a Canadian; relevance of questions on cross-examination as to whether that person controls or "caused" material to be communicated in breach of the *Canadian Human Rights Act*.)

71 (1985) 21 D.L.R. (4th) 174

72 *Ibid* at p. 200.

73 *International Shoe Co. v. State of Washington*, 326 US 310 (1945).

74 Many such statutes now contain a basket clause which if no specific ground is identified, permits jurisdiction on any basis permitted under either the state constitution or the U.S. Constitution; see for example the Illinois statute, 735 ILCS 5/2-209 amended by PA 86-840 (Sept. 1989)

75 1996 U.S. Dist. LEXIS 14978

76 15 U.S.C. , 1125(a).

77 It also noted that individuals in Missouri had accessed the site at least 130 times.

78 *Inset Systems, Inc. v. Instruction Set Inc., supra*, note 41.

79 937 F. Supp. 295, 1996 WL 509716 (S.D.N.Y.).

80 89 F. 3d 1257 (6th Cir 1996)

81 See also *Playboy Enterprises Inc. v. Chuckleberry Publishing Inc. et al* (U.S. Dist. Ct. S.D.N.Y), June 19, 1996. 79 Civ. 3525 (SAS), a copyright infringement case in which the court, in finding jurisdiction, looked to the fact that the defendant, which operated a web site from Italy, actively solicited sales from customers in the U.S. (subscriptions to *PLAYMEN* magazine and related products) and *Weber v. Jolly Hotels* (U.S. Dist. Ct., D.N.J.), Sept. 12, 1997, Civ. A. 96-2582, a personal injury action in which the court, in declining jurisdiction over an Italian hotel which advertised over the Internet, analogized such advertising to advertising in a national magazine which the New Jersey courts have previously held does not constitute "consistent and substantial contacts within the forum state" sufficient to establish jurisdiction. Also see *Blumenthal v. Drudge and America Online Inc.*, 992 F. Supp. 44 (D.D.C., April 22, 1998) in which the court found jurisdiction over an individual resident in California (Matt Drudge) who maintained an interactive web site available to District of Columbia residents, solicited donations from D.C. residents, mailed his report to D.C. residents on his subscription list, appeared in D.C. to promote his report and had contacts with D.C. residents by telephone and mail.

82 See Lori Irish Bauman, "Personal Jurisdiction and Internet Advertising", in 14 *The Computer Lawyer* 1 (Jan. 1997)

83 *New York v. Lipsitz* (NY Sup. Ct), June 23, 1997.

84 Ss. 349, 350, (McKinney, 1988).

85 *Supra*, note 68.

86 See Peter Bartlett and Matthew Deeble, *supra*, note 2.

87 *Ibid*.

88 776 F Supp. 135 (S.D.N.Y. 1991).

89 *Stratton Oakmont Inc. v. Prodigy Services Corp.*, 1995 N.Y. Misc. LEXIS 229, 1995 WL 323710 (N.Y. Sup May 24, 1995).

90 *Telecommunications Act of 1996* 47 U.S.C. s.228

91 See Deborah K. Owen, supra note 56. See also the U.S. government's failed attempt to create criminal offences for transmission of indecent materials to minors under the *Communications Decency Act of 1996*, 47 U.S.C. s.223. The Act contained defences for ISP's who provide mere access and for those who attempt to screen offensive materials and prevent access to minors The Act was struck down by the U.S. Supreme Court as an unconstitutional limitation on freedom of speech; *Janet Reno, Attorney General of the United States v. American Civil Liberties Union*, 117 S. Ct. 2329; 1997 U.S. LEXIS 4037.

92 Subs. 21(1)

93 *Agreement between the Government of Canada and the Government of the United States regarding the Application of their Competition and Deceptive Marketing Practices Laws.* Article VIII, Section 3 of the Agreement reads as follows:

3. The Director of Investigation and Research and the Federal Trade Commissioner shall, to the extent

compatible with their laws, enforcement policies and other important interests:

(a) use their best efforts to cooperate in the detection of the deceptive marketing practices;

(b) inform each other as soon as practicable of investigations and proceedings involving deceptive marketing practices occurring or originating in the territory of the other Party, or that affect consumers or markets in the territory of the other Party;

(c) share information relating to the enforcement of their deceptive marketing practices laws; and

(d) in appropriate cases, coordinate their enforcement against deceptive marketing practices with a transborder dimension.

94 See: R. Larabie-LeSieur, supra, note 26.

95 *Ibid*.

96 The Bill also seeks to enhance the ability of persons to do business over the Net by establishing rules for the use of secure electronic signatures.

97 *The Data Privacy Act*, 1997, (H.R. 2368)

WHO OWNS YOUR WEB SITE?

Hint: It May Not Be You!

WHO OWNS YOUR WEB SITE?
Hint: It May Not Be You!

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Web sites have moved from being a novelty to being a principal means by which businesses attract, communicate and transact business with their customers, suppliers and shareholders. Indeed, many businesses now conduct all of their business over the Net. Having a web site is no longer a matter of being “with it.” Web sites are part of mainstream business operations and are key corporate assets.

The technology underlying the Web is new and continually evolving. Managers and even technical officers are unfamiliar with how the technology operates - they simply know what seems to work. A consequence of the evolution of the Web from novelties to key corporate assets in a very short time is that in many cases none of the procurement and management processes applicable to other key corporate assets have been created or applied.

Thus, there is reason for concern. Ownership rights in web sites are created under the laws relating to intellectual property, including trademarks, copyright, patents and trade secrets. All of these laws impact upon your web site in a myriad of ways. People with whom you have had dealings may have property rights in your site. At the least, such claims may cost you money and aggravation. At worst, they may result in a loss of a valuable corporate asset or even in your web site being shut down.

One area of concern relates to the content, construction and hosting of your web site. A partial list of questions you must ask include:

CONTENT

What content on your web site is protected by copyright? What is the source of the material? If it was not created by you or your employees, has it been licensed or assigned and on what terms? Is the licence broad enough to permit your intended current and future uses? Do you have the right to create derivative works? Do your suppliers indemnify you from copyright infringement? Can you identify what you’ve created internally and what has been supplied by third parties? If the material includes images of persons, have personality rights been obtained? What rights are you conveying to others to use the information posted on your web site?

WEB SITE SOFTWARE

Web sites are typically constructed by internal software developers and engineers, together with third-party consultants and contractors and often with the assistance of the Iweb site host. Third-party software is often used in the development as well as the operation of the web site along with newly created software. Who owns the software that has been created? There is no deemed assignment of copyright for work created by third-party contractors. Have assignments been obtained from your consultants and contractors? Can you even identify which parts are created internally by your employees and which are created externally? What third-party software is being used? Have licences been obtained and who owns the licence?

WEB SITE HOST AND MAINTENANCE

Can you move your web site to a new host server in the event of a dispute with your web host? Are you the registered owner of the domain name that your host acquired for you? Can you transfer ownership and control of your web site in the event of a merger, acquisition or divestiture? If you receive notice of alleged copyright infringement, do you have the right to require your web site host to remove the material? If your web site host receives notice of alleged copyright infringement and removes the material, do you have the right to require the host to display the material (if you believe that you have the copyright to do so)? What back up procedures does your host have? Are you at risk if there is a catastrophic failure of the host? Is your data secure?

Web sites involve complex relationships among a number of parties. The complexity of the relationships, the unfamiliarity of the technology, and the lack of a well-understood and established contractual environment invites the unwary to act on faith. Faith is no longer enough. The stakes are already high and will grow much higher. Your web site should be your property. Take the steps to ensure that it is.

DEVELOPING “HIGH-TECH” BUSINESSES

Holding on to the Brass Ring

DEVELOPING "HIGH-TECH" BUSINESSES
Holding on to the Brass Ring

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Recent years have witnessed numerous 'small cap' technology companies burst into prominence. Willing buyers and investors, fuelled by the supercharged financial markets of the United States, have been eager to offer unimaginable sums of money to these companies or their shareholders to buy their business or technology. In the early stages, the founders of technology companies are usually consumed by technical concerns and by the day-to-day challenges of keeping their new businesses afloat. Then, when suddenly faced with the 'opportunity of a lifetime', they come to the realization that they are, from a corporate point of view, unprepared to grab the proverbial brass ring. The scramble begins to plan and organize to take full advantage of the opportunity; a process that frequently entails enormous effort to develop tax-planning strategies and to clean up loose or disorganized corporate structures. Inevitably this effort comes at significant cost that could largely have been avoided if only some basic planning had been done earlier.

The purpose of this paper is to highlight some of the most common pitfalls experienced by persons involved in establishing new small high-tech companies and to outline strategies to avoid those pitfalls.

DUE DILIGENCE

In order for the founders of new corporate ventures to prepare themselves for future corporate opportunities, it is important to understand the process called 'due diligence' that virtually always precedes the final commitment to purchase or invest. Offers are sometimes made without the benefit of this process but rarely does money change hands until the process is complete. It is not uncommon for deals to collapse at this stage. 'Due diligence' involves a detailed review of every aspect of a company and its business activities aimed at confirming whether its apparent value is truly there and whether everything is in fact as it appears or has been represented. The 'due diligence' process is therefore specifically designed to identify all material risks and vulnerabilities faced by a business.

In general terms, buyers or investors will want to know that the assets, most particularly the core technology of the target company or business are owned "free and clear". Buyers and investors will therefore want to confirm with precision and finality just who owns the core technology. They will want to verify that sales contracts or licenses generating revenues for the company are reliable. All critical supply contracts will be examined. Overall, buyers and investors will try to identify every possible source of potential liability to which the company and the core technology might be exposed.

To the extent that the founders fail to maintain clear records of their business activities, the process of conducting 'due diligence' becomes more time consuming and expensive. Inevitably, if there are risks or liabilities, the process will identify them and the result will tend to reduce the price a buyer is willing to pay or impose additional costs on the seller to clean things up prior to the sale or investment. Accordingly, it is important to maintain clear, consistent and comprehensive records from the beginning. It is important to deal with loose ends and to appropriately document all events that impact on ownership of any assets, including share transfers, insurance issues and agreements entered into by the founders. Accepting this discipline will almost always be rewarded many-fold in enhanced value and substantially reduced fees for legal and accounting services in the context of a sale or investment.

SHARE STRUCTURE

As trite as it may sound, when incorporating a company, it is important to plan for its future growth and even for its ultimate sale. Not surprisingly, most start up businesses operate on extremely tight budgets without cash to spare for 'high-priced' lawyers, accountants and tax advisors. Nevertheless, there are several inexpensive, largely common sense, strategies that will avoid much greater grief and expense later. Most businesses are operated through the vehicle of a limited liability company. Typically, however, the founders and their business 'partners' will operate with the simplest of share capital structures, often, one share per 'partner'. When a buyer arrives on the scene, the focus quickly shifts to finding mechanisms to minimize the tax hit resulting from the sale of the business. Exceedingly complex, and correspondingly expensive, strategies must then be employed to maximize the after-tax proceeds, sometimes at significant risk. Accordingly, it is wise to anticipate the potential for success and design an appropriate corporate share structure from day one.

Start with establishing a flexible share structure. The use of both Common shares and Preferred shares can be a valuable planning tool. Preferred shares may be voting or non-voting and may come with all types of special rights and restrictions that can be tailored to specific circumstances. For example, non-voting Preferred shares may be an ideal mechanism to allow underpaid key employees to participate in equity growth without impacting on corporate control. Preferred shares may be the ideal vehicle to accommodate third party investors through specified dividend rates.

It is important also to ensure that the company is incorporated with a sufficient number of shares to accommodate the potential for bringing in new business 'partners' as shareholders. These business 'partners' may be family members, key employees or investors. With an adequate number of shares and the right kinds of shares, the company will have room for these people without affecting control and without the need for fundamental reoganization that may have adverse tax consequences.

Consider issuing shares early to one's spouse and family members to allow them to participate in profit and equity growth. If you wait until the growth has occurred or the profits are actually earned, the task of avoiding large a tax hit becomes far more complex and risky. While issues of corporate control must not be ignored, there are numerous mechanisms to allow participation in profit and equity growth without compromising control. The use of Preferred shares is one method. Issuing shares into trusts is another.

The founding or incorporating parties should, at the time of incorporation, also allot to themselves an adequate number of shares to ensure that they can maintain control of the company even after additional shares have been issued to investors and employees of the company. Avoid the typical pitfall of founding shareholders who tend issue to themselves only a nominal number of shares resulting in a situation which will later unnecessarily limit their flexibility.

BUY-SELL AGREEMENTS

'Buy-sell' or 'shareholder' agreements are agreements among shareholders of private companies that govern a wide range of issues related to corporate ownership, governance and control. It is always easiest to put such agreements in place as soon as possible after incorporation, when there are fewer shareholders and before the stakes become too high. In the typical example, two people will collaborate on the development of a new technology and agree to market that technology through a company with each owning half the issued shares. It is essential that they take the further step of putting in place an agreement as to how the company will be controlled and managed, particularly when difficult issues arise. What will happen if there is a dispute? Worse still, what happens if one of them gets divorced or dies? What if one of them wants to sell? How will additional shareholders be accommodated? It is easy to see that as a business grows, these issues will become increasingly difficult to resolve. In some instances, companies are paralyzed by the absence of such an agreement.

Consider the sad but all too common example where the two founders of a company issued shares to a key employee shortly before a lucrative buy-out offer materialized. Knowing the offer was contingent upon all the shares being sold, the key employee quickly recognized that he had substantial leverage beyond the value of his shares as he effectively held the power to veto the sale. The two founders, who had much more to lose, were held to ransom. This predicament could have been avoided by a simple shareholders' agreement.

A properly constructed buy-sell or shareholders' agreement will anticipate a wide range of events and circumstances and provide mechanisms to deal swiftly and conclusively with these situations if and when they arise. They may contain terms that can force one or more shareholders who wish to either sell their shares or buy-out other shareholders to conduct such a sale or purchase in a certain way. One such mechanism is called a 'shotgun clause' where one shareholder can make an offer to buy the shares of another but, in doing so, automatically gives the other the right to buy his shares for the price offered. The effect is to force buy-out offers to be made on reasonable terms if one of the shareholders wants out.

The typical shareholders agreement will deal with corporate governance issues such as the appointment of officers and directors. Certain important corporate decisions may be identified as requiring the approval of a super-majority of or even unanimity among shareholders. They will also generally impose restrictions on the right to transfer shares and to issue additional shares. Of course, it is essential as new shareholders are added to ensure that they too become parties to any buy-sell or shareholder agreements and that the terms of the agreement are appropriate to deal with changing circumstances.

TAX PLANNING

The incorporation stage is also the best time to set up mechanisms to minimize tax consequences for when the corporation becomes profitable. One common example is to split share ownership with other lower-income family members (usually the spouse and children). The result is that any dividends paid on the shares or any funds received from the sale of the shares will be taxed at the lower rate applicable to that family member, as opposed to the founder's higher tax rate. This type of tax planning becomes increasingly difficult to implement as the value of the company increases. It is therefore important to consult a tax expert at the time the company is established.

MINUTE BOOKS AND ACCOUNTING

As obvious as it may seem, it is important to ensure that the company's minute books and financial documents are properly maintained and that all filings are made with the Registrar of Companies and relevant tax authorities on a timely basis. These items are usually the subject of particularly careful scrutiny during the 'due diligence' process, already discussed.

Horror stories abound in this area. As companies struggle for survival in their formative stages, it is not uncommon for shareholders to come and go, for offers to acquire shares to be made and for share purchase options to be granted. Frequently, these things are done in an informal way without the benefit of detailed written records, agreements and other appropriate documentation. Often this leads to uncertainty and disputes, particularly when the stakes get higher and more money is on the line. Buyers will want to know with absolute certainty who the shareholders are, how many shares are issued and what rights there may be to acquire additional shares. Accordingly, it is absolutely essential to maintain accurate records of share issuances, transfers, sales, cancellations and the like. If shareholders leave, document how their shares have been disposed of. It is not uncommon for continuing shareholders to simply ignore the departure of a minor shareholder. Unless that minor shareholder is fully and effectively removed as a shareholder, and that removal is properly documented, he will be in a good position to potentially create a serious problem if a lucrative share purchase offer is presented.

It is not uncommon for the 'due diligence' process to reveal that share registers are not up-to-date, that share certificates are unaccounted for and that required waivers, approvals and resolutions have not been obtained. These are issues that cause delay and significantly increase costs.

STOCK OPTIONS AND PLANS

When granting stock options and putting in place employee stock option plans it is important to ensure that the principals of the company are not unnecessarily diluting their corporate governance powers. Often, in the initial stages of the high-tech company, issuing share options to key employees is more fiscally feasible than providing cash bonuses or high salaries. The founders must therefore keep in mind that any type of transaction they undertake in the future may be jeopardized if their shareholdings have become too diluted. To prevent this type of dilution, the founders will have hopefully, at the time of incorporation of the company, already issued sufficient shares to themselves to be able to safely grant some to other parties. The founders must also be mindful that each additional grant of shares, however small, both dilutes their own voting power and may also bring other personalities into the company's decision-making process.

In situations where a company is about to enter a new phase of development or expansion, perhaps by way of a major financing or through acquisition or investment by an outside party, it is important that the founders maintain a sufficiently large control block of shares to ensure that they can continue to effect business decisions efficiently and in a timely manner. Dealing with dissenting shareholders or a fragmented shareholder base in a private company is a costly and time-consuming endeavour.

OWNERSHIP OF INTELLECTUAL PROPERTY ISSUES

It is particularly important for technology companies to ensure that the technology they rely upon as their major asset is properly protected and properly held. If, as is often the case, the technology is licenced to the company by the inventor or developer, the terms and conditions of the licence must be clear in all respects and must be carefully documented and crafted to allow the growth and expansion of the business and perhaps also its sale. The terms of the licence function as the foundation upon which the whole business will rest. Any weakness can make the entire business vulnerable. Potential buyers, investors and financiers will seek concrete assurances with respect to ownership of the technology and the exact nature of all rights and obligations under the licence. It is therefore essential that the terms of the technology license be fully and properly documented with as much built in flexibility as possible for the licensee.

Another potential pitfall with respect to the ownership of intellectual property are the disputes that arise when employees or contractors of the company begin to claim proprietary rights in part or all of the company's technology. The founders of the company must be extremely vigilant and even ruthless to protect the company's ownership and control of its intellectual property. It is important to remember that absent an agreement to the contrary, the intellectual property developed by a contractor while working on a company's technology will belong to that contractor. It is sometimes difficult to sort out just who may have contributed to the development of new technology and what their position might have been at the relevant times. The result may be latent ambiguities regarding ownership of intellectual property that will become manifest once the stakes are raised.

It is therefore prudent to put in place a requirement that all employees of the company who work with the technology agree that any improvements or modifications of the technology will be and remain the exclusive property of the company. They should also agree that they have no rights to such improvements or modifications. When engaging consultants or contractors to work on development projects, ensure that the agreements expressly provide that ownership of all intellectual property rights will accrue to the company.

AGREEMENTS WITH EMPLOYEES AND CONSULTANTS

In many small high-tech companies there are a few employees who are vital to the maintenance and development of the company's technology. Often, it is not clear whether a person serves as an employee or contractor and the problem is further complicated by the fact that the industry is characterized by the mobility of talented personnel. Against this background it is important to ensure that all such persons enter into written employment or consulting agreements that contain clear provisions to protect the company's intellectual property. Too often start-up technology companies content themselves with simple 'confidentiality agreements' that restrict certain disclosure of confidential information to third parties. These agreements frequently fail to prevent the use of that information for the personal benefit of the employee or consultant or of another employer.

CONCLUSION

While the issues discussed in this article are relevant to any small business, they are particularly important for companies in the high-tech and information technology industry where success may be fleeting, where growth is often explosive and mercurial, and where opportunities may disappear as quickly as they appear. Ensuring that a company in this industry has a robust corporate structure and clean, up-to-date, corporate records will help to ensure that the company is able to take advantages of opportunities quickly and efficiently. An ongoing internal 'due diligence' process is also a good discipline to adopt and to follow. In the coming decade, the high-tech and information technology industry will no doubt continue to grow rapidly and the prudent founder will be ready to seize and hold onto the brass ring when it appears.

COMPUTER SOFTWARE & INTELLECTUAL PROPERTY LAW IN CANADA

COMPUTER SOFTWARE & INTELLECTUAL PROPERTY LAW IN CANADA

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COPYRIGHT & SOFTWARE

What It Is

Copyright arises automatically in Canada upon the creation of any original literary, dramatic, musical or artistic work, including books, manuals, brochures, paintings, drawings, maps, sculptures, symphonies, computer software, etc. Copyright protects the specific way in which the ideas are expressed in tangible form; it does not protect the underlying ideas. Copyright gives the owner of the work the sole right to produce, reproduce, perform or publish the work or any substantial part of it in any form. Thus, the unauthorized copying of off-the-shelf software, even when validly purchased, constitutes copyright infringement, as does the rental of software without the copyright owner's consent. However, it appears that electronic databases, where the data has been compiled with minimal creativity, are not protected by copyright. On the other hand, electronic versions of music, graphics, books and plays are protected, even on the Internet, because copyright extends as fully to the Internet as it does to other media, even though enforcement may be more difficult.

Impact of Treaties

Eligibility for copyright protection in Canada extends far beyond works created by Canadian citizens and permanent residents and works first published in Canada. Since January 1, 1996, due to Canada's implementation of the Agreement on Trade-Related Aspects of Intellectual Property Rights, copyright protects almost any original work published anywhere by anyone. For the few authors that would not be protected, because their home states are not signatory to one of the major copyright treaties, the Minister of Industry can extend protection if the non-treaty state protects Canadians similarly to its own citizens.

Ownership

Generally, but subject to some exceptions, such as an employee creating works in the course of his or her employment, the author or creator of a work will be the work's first owner. One common exception in the software industry is a programmer working on contract, who will be the owner of the software he or she develops in the absence of a written agreement to the contrary. A copyright owner may assign or license the copyright in whole or in part. This is generally the process by which an organization acquires rights in software code developed by a contractor.

Duration

The duration of protection varies with the type of work. For literary works, which includes software, copyright protection begins at the moment of creation and doesn't expire until 50 years following the author's death. In the case of joint ownership, very common in software situations, protection endures for 50 years following the death of the last of the joint authors to die.

Effects of Registration

Copyright protection is available in Canada whether or not a work has been registered with the Canadian Copyright Office. However, if a copyright is properly registered with the Canadian Copyright Office, enforcement in court is facilitated. For example, in a dispute over the validity of a copyright, registration creates a legal presumption that the copyright is valid and that the person who registered it is the true owner. Registration also broadens the available remedies and facilitates assignment and licensing. For example, registration entitles the owner to statutory damages once infringement is proven. Registration is a short and inexpensive procedure that should be seriously considered by copyright owners.

Moral Rights

Canadian law recognizes the moral rights of creators of literary works, including computer software. Moral rights include the right to protect the integrity of the work, and the right to be (or not to be) associated with the work. Those dealing with computer software must ensure that their proprietary interests and commercial objectives will not be encumbered by a creator's moral rights. Moral rights are especially relevant in website content issues and the multimedia sphere, where elements of content can be modified so easily. Moral rights cannot be assigned, but copyright owners can agree to waive enforcement of their moral rights.

Remedies For Infringement

An owner may institute court proceedings against anyone who infringes his or her copyright. The relief available includes: (i) an injunction to prevent further infringement; (ii) damages for any loss caused by the infringement or an accounting of the infringer's profits; and (iii) the delivery up or destruction of the infringing articles. There are also provisions in the Copyright Act(Canada) declaring certain acts of copyright infringement to be quasi-criminal in nature.

PATENTS & SOFTWARE

What is Patentable

A patent will be granted for any new (i.e. was not known more than 12 months before the application was filed), useful (i.e. has industrial utility) and unobvious (i.e. exhibits inventiveness beyond the industry average) art, process, machine, manufacture or composition of matter, or any new and useful improvement to any of the above. Conversely, if not new, or useful, or exceptionally inventive, an invention cannot be patented. As well, patents will not be granted for inventions that have an illicit purpose, or for scientific principles or abstract theorems. Today, patents cover a wide variety of computer-related devices, including writing heads in computer hard drives. The patenting of software, a relatively recent development, is discussed below.

Patenting an Invention

An inventor is entitled to obtain a patent if he or she is the first person to fully disclose the invention in a patent application. A patent agent will draft the patent application which is then filed in the Canadian Patent Office for examination. For a successful application, it is essential that the invention be fully disclosed, and that the claim (which outlines the scope of the monopoly) be precisely structured. If not sufficiently disclosed, the patent may be denied or, if issued, may be later challenged in court by a competitor. If the claim is too broad, the applicant takes the risk of being too similar to a previous product or process and of having the claim declared invalid; if the claim is too narrow, the applicant may have reduced the scope of his or her legitimate monopoly. A separate patent must be obtained in each country in which protection from infringement is sought.

If a patent application is filed in Canada within one year after an application for the same invention is filed in a country adhering to the Paris Convention, the filing date in Canada is deemed to be the date of filing in the Convention country.

Advantages To Obtaining a Patent

Subject to certain conditions, a patent provides the patent owner with the exclusive right throughout Canada to manufacture, use or sell the invention for 20 years from the date of filing of the patent application. Unlike copyright, a patent is effective against anyone, even a party that has created an identical invention independently of the patented invention. In addition, by granting a licence permitting another individual to use, manufacture or sell the invention, a patentee may gain market access more readily while earning royalties from the licensee.

Remedies for Patent Infringement

he patent owner may bring a court action against anyone who interferes with the monopoly granted to the patent owner without the consent of the patentee. If patent infringement is proven, the patent owner may obtain relief comparable to that discussed earlier concerning copyright, i.e. injunctive relief, damages, accounting of profits and surrender of the infringing goods. An infringer is liable for all damages sustained by a patent holder, and may be liable to pay punitive damages as well.

Patents For Software

In dealing with patents for information technology, it is important to distinguish between computer hardware and computer software. In terms of hardware, the patentability of computer hardware has not been questioned, and is subject to the same criteria under the *Patent Act (Canada)* as all other technology. In terms of software, for many years, software patents were not granted in Canada based on a provision of the *Patent Act (Canada)* (still in force) which states that a mere scientific principle or abstract theorem is not patentable. Indeed, a computer program per se, an algorithm, or a set of instructions to operate a computer (essentially mathematical information developed from an algorithm) is not patentable. Since the mid-1980's, however, the Canadian Patent Office has been allowing patent applications that consist largely or entirely of computer software, especially where the applications are skillfully drafted to include hardware elements, and where the nature of the program goes beyond a mere algorithm, or mathematical formula, and constitutes a methodology, process or control system. This substantially reflects the recent State Street decision in the United States, which reached a similar conclusion.

TRADE MARKS & SOFTWARE

What is a Trade Mark

A trade mark is any word or composite word, name, symbol, design, slogan, get-up or device, or combination of same, used for the purpose of identifying the origin of the goods or services manufactured, sold or provided by the user and distinguishing them from those manufactured, sold or provided by others.

Value of Trade Mark Registration

Although rights in a trade mark arise and may be enforced without registration, in order to maximize its trade mark rights in Canada, a trade mark user is well-advised in many if not most cases to register the trade mark under the *Trade-Marks Act* (Canada). It makes good business sense to register a trade mark for the following reasons:

(a) to stop trade mark infringement, the owner of an unregistered trade mark is restricted to the common law action of "passing off" (known as "unfair competition" in the United States). In such an action, the plaintiff owner has the burden of proving that its trade mark is associated in the market with its wares or services and that such trade mark actually distinguishes the plaintiff's wares or services from those of others. If a trade mark is registered, the owner is relieved of this burden;

(b) when a trade mark has been registered, the trade mark owner's exclusive right to use the trade mark extends to the whole of Canada, even if the registered trade mark is not known or used in certain parts of the country. In the absence of registration, protection is normally confined to the geographic area in which the owner can prove it has developed goodwill in the trade mark;

(c) registration of a trade mark provides additional protection against a third party using the mark in a manner that would cause depreciation of the goodwill attached to the mark;

(d) registration of a licensed trade mark makes it more difficult for the licensee of the trade mark (or another party) to claim that the licensee's use of the trade mark has resulted in the licensee acquiring ownership rights in the trade mark at the expense of the owner.

Trade Mark Registration

To obtain the benefits of a registered trade mark in Canada, an application must be filed with the Canadian Trade-Marks Office. A registered trade mark agent is entitled to sign the application on behalf of the applicant and no power of attorney is necessary. A trade mark which is "allowed" by the Trade-Marks Office is then advertised (published) and may be opposed. Consultation with a specialist in this area is essential to avoid an expensive and futile attempt to register a trade mark.

Restrictions

The Trade Marks Act contains provisions which limit or prohibit the registration of certain marks. For example, marks that are clearly descriptive of the subject ware's or services are not registrable. In the world of software, where it can be a competitive advantage if a product describes its function, this rule makes it important to adopt trade marks that 'suggest' rather than describe product attributes, e.g. 'Microsoft', or to choose trade marks that have no clear relationship to the product, such as 'MacIntosh'. In addition to clearly descriptive marks, marks which are confusing with those already in use or registered may be denied registration.

Convention Priority

A party can apply for registration of a trade mark in Canada even if the mark is not yet in use in Canada, based on an intention to use it. If the trade mark is ultimately registered, its priority will be retroactive to the date the application was filed. For applications from the U.S. and other foreign countries that are signatory to the various international treaties, the date of filing in the foreign jurisdiction will be honoured as the priority date in Canada, as long as the Canadian application is filed within six months of the foreign filing.

Licensing of Trade Marks

Although trade mark licenses need not be in writing, to clarify the license terms, especially the owner's rights to control use of the trade mark, such licences should be in writing, and markings on the product or packaging should indicate that the trade mark is being used pursuant to a license from the owner. Trade mark licenses do not need to be registered.

Renewal

To maintain a trade mark registration, registration must be renewed every 15 years from the day of registration or last renewal; failure to renew will result in cancellation of the registration, though not necessarily of the owner's common law trade mark rights. Trade mark rights can also be lost by non-use or abandonment, by allowing others to use confusing or non-distinctive trade marks or by improper licensing.

Remedies for Trade Mark Infringement

The owner of a registered trade mark has the exclusive right to use that mark throughout Canada in connection with the goods or services for which it is registered. The owner may institute court proceedings against anyone who infringes this right or uses a confusingly similar trade mark. . If trade mark infringement is proven, the trade mark owner may obtain relief comparable to that discussed earlier concerning copyright and patents. As discussed above, an unregistered mark can be enforced by an order prohibiting the infringing party from passing off its infringing mark as the genuine mark.

Internet-related Trade Mark Issues

Much of Canadian Intellectual Property Law is similar to U.S. law. In the Internet sphere, due to the scarcity of case law in Canada, and the relatively large amount of case law from the U.S., there are even fewer distinctions at this point. Canadian courts simply have not dealt with many of the issues, and where they have, they have often displayed little understanding of the technology or the relevant principles. Accordingly, what follows is basically a reading of U.S. law, viewed from a Canadian perspective.

Meta Tags

These are names or symbols or key words, written in HTML, the language of websites. They are used by developers to 'mark' websites for the purpose of being indexed on search engines like Yahoo or Alta Vista in order to enable people conducting web searches to find products and services. Thus, use of one's own trade marks as meta tags is not only acceptable but also a wise strategy. However, use of the trade marks of another party to cause the search engines (and the general public) to think that the website of one party is the website of another is likely to invite liability for trade mark infringement.

Domain Names

These are names assigned by the various domain name registration authorities to identify registered websites. Because they serve to identify and distinguish goods and services, they can be considered trade marks, subject to protection like other trade marks. However, because domain names also function more or less as Internet 'telephone numbers', in that there are no two exactly alike, they often conflict with registered trade marks, which are categorized roughly according to industry, such that there can be more than one that are identical, except for the goods or services they describe. This issue has yet to be resolved to anyone's satisfaction. For now, to protect one's trade mark rights it is advisable to register a domain name to match each important trade mark, and to register a trade mark for each domain name, although it appears that the ‘top level’ domain names, e.g. .com, .org or .ca, etc. need not be included in the trade mark as registered. It is also useful to note that a trade mark that is used in commerce but not registered will probably have priority over a domain name that is not registered until after the trade mark is first used.

Cybersquatters

Cybersquatting refers to an activity involving domain names whereby a party acquires a domain name identical to a well-known trade mark for the purpose of selling the domain name to the trade mark owner for a substantial sum of money. Although there is often no actual use of the domain name in connection with a product or service, such that there is no infringement in the traditional sense, U.S. courts seem to be responding to the extortionate nature of cybersquatting by declaring it to be ‘trade mark dilution’ (the Canadian counterpart is ‘depreciation of goodwill’) and granting injunctions and similar relief to trade mark owners. Whether Canadian courts would adopt the same approach is unclear. But to this point, Canadian lawmakers have not seen fit to enact an anti-cybersquatting statute as the United States has just done.

New Domain Name Registration Systems

A new Canadian agency called CIRA (Canadian Internet Registration Authority), with a mandate to administer the .ca top level domain, is scheduled to begin operation on December 28, although it is not likely to be operational until early in the year 2000. Both Canada and the U.S. will have new systems in place within the next few months. The system envisaged is an automated, electronic, first-to-file system, with conflicts to be handled by a dispute resolution mechanism after the fact. However, CIRA is still accepting input on the registration and administration process, and it is hoped that the final result will be an improvement over what now exists.

TRADE SECRETS/CONFIDENTIAL INFORMATION & SOFTWARE

What Are Trade Secrets

Trade secrets (also called “confidential information”) can relate to a product (e.g., a new release of a software package), a process (e.g., a unique method for making a product), technology (e.g., the “know-how” that makes the production aspect of a certain business more efficient) or a collection of strategic business information (e.g., customer lists and internal marketing strategies). Trade secrets have been defined as (i) information (as described above) which is or may be used in a business, (ii) is not generally known in that business, (iii) has economic value from not being generally known, and (iv) is subject to reasonable efforts to maintain its secrecy. Trade secret protection arises upon creation and, as long as the information is kept confidential, there is no limit to its duration. Unlike with patents, copyright and trade marks, there is no statute or registration system in Canada designed to protect trade secrets, and an owner’s remedies are restricted to those available at common law (or in Quebec, the Civil Code). The characteristic of "secrecy" is essential to an owner's continued rights in the secret.

Protecting Trade Secrets in Canada

In recent years, the protection of trade secrets has become more important for at least two primary reasons. First, because the life-cycle of new technology is so short, use of the slow-moving, statute-based intellectual property protection mechanisms to protect related confidential information is not an effective option. Second, the increasing mobility of employees has increased the opportunities for trade secrets to leave the company premises and be divulged elsewhere.

From a 'preventative medicine' posture, protection of a company's trade secrets and confidential information best occurs through a combination of effective internal policies to preserve the confidential aspect of information and contracts with employees and third parties (such as prospective suppliers, customers and joint venturers) which characterize certain information as trade secrets and specify the obligations which bind them. The necessary contractual terms and internal policies should be developed with the assistance of a lawyer to ensure that trade secrets will be adequately protected and to ensure that contracts entered into with employees and third parties will be enforceable by the courts.

From a 'treatment' perspective, trade secrets can be protected by an action for misuse of confidential information. To establish such a claim, it must be shown that: (i) the information was confidential; (ii) it was communicated in confidence; and (iii) it was misused to the detriment of the confiding party.

Canadian courts have implied an obligation of good faith into the employer-employee relationship and have prevented former employees from using their employers' trade secrets after the employment relationship has ended. Persons who occupy positions of trust (e.g., directors of a corporation) owe even higher duties of allegiance to the companies they represent. These duties, called fiduciary duties, include the obligation not to utilize corporate opportunities or other confidential information gained in a fiduciary capacity.

Remedies

Once a trade secret is made public, its value is significantly diminished or eliminated. Therefore, the usual remedy sought to prevent disclosure is an injunction restraining another party from using or disclosing the trade secret, combined with damages.

What Is An Industrial Design

A registered industrial design (called a "design patent" in the United States) provides protection for the ornamentation of any article of manufacture. It relates to matters of appearance, not function. That is, the feature must exist because of design considerations, not functional considerations.

Purposes of Industrial Design Registration

Any manufacturer who has an eye-catching design for a product that is easily replicated should consider registering the design. As well, any company thinking of spending a large sum on tooling for a new product should check to ensure there are no registered designs which are likely to force them off the market.

Industrial designs cannot be protected under the *Copyright Act*, and therefore the only protection available to them results from an industrial design registration. Consultation with a specialist in this area is essential to ensure the protection of your property by registration under the proper statute and to avoid infringement of the industrial designs of others.

Industrial Design Registration

The owner of a design who applies for registration must deposit with the Industrial Design Section of the Patent Office a drawing and a declaration that the design is not in use by any other person. The Commissioner of Patents will then register the design, if, after examination, a previously registered design is not revealed. A certificate of registration will then be sent to the applicant. It is recommended that prior to sale, each article to which the design is applied, or its labelling or packaging, be marked with the symbol • together with the name of the owner of the design. Without such marking, the owner's remedies for infringement may be restricted to an injunction. Such marking also enables anyone wishing to negotiate a license to know with whom to deal.

An application for registration of the design must be filed within one year of the first publication of the design in Canada or elsewhere. If the design is not registered, it will not have legal protection.

Remedies for Industrial Design Infringement

Registration of an industrial design provides the registered owner with the exclusive right to apply that design to an article for the purpose of sale for a ten-year period, subject to the payment of maintenance fees. The owner of a registered industrial design may bring an action against anyone who applies or imitates the design without the consent of the owner. In such an action against an infringer, the owner may obtain relief comparable to that discussed above concerning copyright, patents and trade marks.

INTEGRATED CIRCUIT TOPOGRAPHY ACT

What It's About

This rarely-used statute provides exclusive rights in the design or topography of integrated circuits (i.e., semiconductor chips). This legislation, which came into force in May 1993, was passed partly to take advantage of the reciprocal protection provided by parallel U.S. legislation. However, it embodies several significant departures from the U.S. law. For example, while the U.S. law provides for certain exceptions to exclusivity rights, it is clear that in Canada a person may not "reverse engineer" a registered topography for commercial purposes. As with patents, there is no common law protection for topographies. Protection requires registration in accordance with the statute.

Why It's Relevant

Although the statute does not apply to software, it is somewhat relevant because it was developed out of the perception that the protection of semiconductor chips was not appropriate under either copyright or patent law, in that topographies are too much like blueprints or drawings to be covered by patent law, yet too machine-like to fall under the protection of copyright. Since this type of debate is similar to the one concerning the proper home for software protection, it may provide some guidance as to how the software issue can be resolved.

COMMERCIAL TRANSACTIONS & SOFTWARE

There are numerous and varied legal issues related to information technology that present unique challenges under Canadian law. For example, "shrink-wrap" software licenses may not be enforceable as contracts against users; software escrow arrangements must be considered in the context of Canada's unique bankruptcy and trade-creditor protection laws; differences in provincial laws may affect national distribution transactions or information networks or the language spoken at a software company's head office; Canadian competition and advertising laws should be considered when structuring distribution and marketing arrangements (i.e., "outsourcing" and reseller transactions); and Canada's technology export restrictions have tended to be more liberal than those of the United States (e.g., Cuba does not appear on Canada's export control list).

ELECTRONIC COMMERCE & SOFTWARE

Many Issues

There are many aspects of international electronic commerce that must be considered under Canadian law, including evidence admissibility tests for electronic records, tax and custom laws concerning electronic records, privacy issues, regulatory requirements for electronic transactions under various statutes and issues related to the formation of contracts via electronic communications.

Protection of Personal Information

One of the most important issues relating to e-commerce is the protection of personal data. In October 1998, the Canadian government introduced Bill C-54, entitled the *Personal Information Protection and Electronic Documents Act*. The Bill's stated intention is "to provide Canadians with a right of privacy with respect to their personal information that is collected, used or disclosed by an organization..." other than information collected, used or disclosed for domestic, journalistic, artistic or literary purposes. The Bill outlines what organizations can and cannot do with personal information provided by individuals to organizations, with the underlying principle being that organizations must clearly indicate their reasons for collecting the information requested, and conversely, must use the information collected only for the purposes originally indicated.

PRIVATE COMPANY
SHARE INCENTIVE PLANS

PRIVATE COMPANY SHARE INCENTIVE PLANS

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The importance of share-based incentive plans has grown significantly in recent years. Key reasons for this include

(a) the proliferation of start-up companies in which cash is scarce and share-based incentives represent some of the most lucrative items of the total compensation package, and

(b) the ability of key personnel to ask for and obtain a piece of the pie, especially in a knowledge-based business.

Too often, one sees the proposal or adoption of a share-based incentive plan in a format that simply follows a particular precedent without adequate consideration of the underlying tax and other factors that can affect the substantive economics of the specific arrangement. Tax aspects, in particular, can significantly affect the value of the incentive package to the employee, on the one hand, and the true cost to the employer, on the other hand.

The terms of a specific incentive plan can be as varied as the imagination of the planner permits. In this article, we will review basic tax and legal issues relating to common types of share incentive plans adopted in business by private companies. Specifically, we will review those attributes in relation to (i) stock option plans, (ii) share purchase plans, and (iii) bonus plans payable in the form of shares or by reference to an increase in share value.

PAYMENT FOR SERVICE OR PAYMENT FOR SOMETHING ELSE

In approaching any particular plan, the first consideration should be whether the granting of a share-based incentive is in substance intended to compensate the recipient for a service of some kind (e.g. employee, director), or whether the share-based rights are really intended to compensate the recipient for something else. Where the share-based plan is intended to compensate the recipient for a type of service, the underlying assumption is that the value of the compensation would normally be income to the recipient for rendering the service, and therefore some particular tax structure or Revenue Canada administrative concession should be found to ameliorate the full income inclusion to the recipient, or perhaps to defer the timing of that income inclusion. This can usually be accomplished under “standard” stock option plans or similar plans, as discussed in more detail below.

*with thanks to Kalle Soomer (Lang Michener, Toronto)

Where, instead, the share-based rights are intended to compensate the recipient for something other than services, the nature of what the recipient provides must be examined to determine the tax effects, and those tax effects will often differ from those associated with a payment for services. For example, the "something else" provided by the recipient may be

(a) cash; i.e. where the recipient is essentially an investor, in which case the granting of the share-based rights may not be taxable in itself if the individual is paying fair value for the investment, and in that case the individual will usually be subject to normal capital gains taxation on an eventual sale (depending on the specific facts), or

(b) the transfer to the company of property of some type; for example, the individual may be transferring an invention, knowledge-related rights or claims, in exchange for shares in the company, in which case the individual's tax consequences will often differ substantially from those of a person providing a service.

The balance of this article considers those circumstances where a particular share-based plan is intended to be an incentive plan for services, i.e. whether to employees at large or to directors or other persons treated as employees for income tax purposes.

INCOME TO SERVICE PROVIDERS

A payment of cash by an employer company is normally taxable income to a recipient who is a service provider. Salary paid to employees (100% taxable income) is the most obvious example. A cash payment to a director (for example, for attending directors' meetings) is equally taxable and a director or officer is generally considered to be an employee for tax purposes.

In the same way as a cash payment would be income to the recipient in these circumstances, the value of anything else provided by the company would normally be income to the recipient. Therefore, in the absence of special rules under the *Income Tax Act* (the "Tax Act") (and a plan that will fit within those rules), any sort of incentive offered by a company may have to be valued for the purpose of determining the income inclusion and, in the case of employees, included in income at the time the incentive is received. This could significantly erode the true economic incentive associated with a plan that does not fit particular rules, especially in the context of a private company. Few employees would consider themselves advantaged by receipt of a taxable employment benefit in the form of largely illiquid shares or options. For these and other reasons, it is important that the plan is structured to fit within specific tax rules that permit a degree of certainty, and preferably, some tax relief.

SPECIAL CATEGORIES

The Tax Act and related Revenue Canada administrative policy provide specified tax results to specified types of share-based incentive plans. Whatever technical issues may be faced in determining the tax consequences of a particular plan "sanctioned" by the Tax Act, such technical issues are often less problematic than the valuation and related tax issues that could arise if a particular plan does not fall within recognized provisions of the Tax Act.

Therefore, there is good reason to create a plan that falls reasonably squarely within recognized provisions of the Tax Act and Revenue Canada guidelines. Within those parameters, there is still scope for structuring a plan that is to some extent tailor-made.

STOCK OPTION PLANS OF PRIVATE COMPANIES

General

This is the most common form of share-based incentive plan for employees working for a start-up or other private company. From an economic perspective, it offers the employee significant "upside", and at the same time permits the company to build in provisions that can be as specific as needed to ensure the incentive is not "wasted". For example, the stock option could provide for "vesting" based on a duration of employment in good standing, or could be more specific by providing that the option may not be exercised unless and until the particular employee meets specific "milestones".

A stock option plan often provides favourable tax treatment to the employee both in terms of the tax rate and (where the company is a Canadian-controlled private corporation) by deferring tax until the last possible moment, i.e. when the stock option benefit is truly realized upon a sale of the share after exercise by the employee. This is reviewed in more detail immediately below. However, it is important to recognize that the granting of a stock option provides a less favourable tax treatment to the company than a cash bonus or payment. This is because the Tax Act specifically prohibits the company from claiming any deduction with respect to the employee stock option.

The lack of deduction to the company is often not considered a major factor, perhaps because the company has sufficient start-up losses or other deductions so as to make an additional deduction relatively immaterial, or because the stock option grant does not involve a cash outlay, or perhaps because the popularity of stock options simply mandates the grant.

No Tax at Time of Grant

The Tax Act specifically provides that the granting of a stock option to an employee is not in itself a taxable event. The taxable event arises only when the employee does something with the stock option (e.g. transfers the option itself, or exercises it and sells the underlying shares).

Deferral of Tax

The most common example is that of a Canadian-controlled private corporation ("CCPC") that grants an option to an employee to acquire shares of the CCPC at an exercise price equal to the fair market value of the shares as of the time the option is granted. In the common example, the employee will hold the option and not exercise it until the share can be sold (either to another private party, or through the market once the company becomes public). In these common circumstances, the taxable benefit to the employee will normally arise only when the shares are sold. This beneficial result depends on meeting a number of requirements, most important of which is that the company meet specified tests set out in the Tax Act for a CCPC, and that the employee must be dealing at "arm's length" with the company when the option is granted. Unless the employee controls the company or is a member of a related group that controls the company, "arm's length" dealings are a question of fact. In many if not most situations, one would expect the average employee to be dealing at "arm's length" with the company for tax purposes and in fact. Absent special considerations, even a director or officer would most often be viewed as acting at arm's length with the company unless the particular individual is in a position to control the company. Each case, though, must be evaluated based on its particular facts.

Taxable Benefit on Sale

An employee who exercises the option at the time of selling the shares is subject to tax on the employment benefit thereby realized. The amount of the taxable benefit is equal to the value of the shares at the time the option is exercised, net of the option exercise price. It is recognized that there may be significant uncertainty associated with the valuation of shares of a private company; however, if the shares are sold to an arm's length party (perhaps another employee), the sale price will likely be a useful determinant of the amount of the taxable benefit. The taxable benefit so computed is included in computing the employee's income. A sale of the shares back to the company involves special tax considerations not reviewed in this summary.

Special Deduction

A special deduction is available where a number of requirements are met, the most significant of which is usually that the stock option exercise price was set at an amount equal to the fair market value of the shares at the time the option was granted. Again, the potential uncertainty associated with determining fair market value mandates a careful approach. Where the special deduction is available, the overall effective rate of tax on the taxable employee benefit is equivalent to the capital gains rate. This does not mean that the employment benefit is a taxable gain, however, and therefore the employment benefit can in no way be offset by any otherwise-available lifetime capital gains exemption.

Exercise of Option Before Sale

In the case of an employee who exercises the option "early" and continues to hold the shares for some time, somewhat different considerations apply. The amount of the employee's taxable employment benefit is measured in the normal fashion (i.e., by reference to the stock option exercise price and the value of the shares as of the time of exercise) and the timing of the income inclusion is again deferred until the shares are actually sold. In addition, though, the employee may have a gain or loss on the shares based on his or her period of ownership of the shares themselves (i.e., after the options are exercised). For this purpose, the gain or loss considers the employee's cost of the shares, for tax purposes, to include the full amount of the employment benefit. Any gain or loss so realized by the employee will normally qualify as a capital gain or loss. In appropriate circumstances, and where numerous requirements are met, a resultant capital gain on shares of a qualifying CCPC may be eligible for the $500,000 capital gains exemption. For this reason, it may sometimes be advantageous to exercise an option "early", but doing so by reference to an anticipated use of the $500,000 capital gains exemption should never be contemplated without detailed advanced review by a tax professional.

Where the shares acquired on exercise are held by the employee for at least two years, there is scope for obtaining the special deduction referred to above even if the option exercise price was a discount to the fair market value of the shares as of the time of grant.

Special considerations arise where the company becomes a public company, or where the employee intends to sell the shares back to the company or intends to sell the options themselves, and again, all these circumstances mandate a careful approach and advanced review by a tax professional.

Special Ontario Proposals

In its 1999 budget, the Ontario government proposed a new credit to reduce the Ontario income tax on the exercise or disposition of qualifying stock options granted by companies engaged in research and development activities. Employees, other than directors, who live in Ontario and own less than 10% of the shares of any class of qualifying corporations are intended to be entitled to the credit. A further restriction is that the credit is intended to apply only to those options that qualify for the special deduction referred to above.

The proposed credit is said to be intended to "substantially reduce or eliminate" the Ontario income tax associated with qualifying stock options granted by companies engaged in research and experimental development. As of October 1, 1999, however, the Ontario Ministry of Finance was still soliciting input in refining the proposal, and accordingly it may be some time before the legislation is available. The Ministry of Finance of Ontario on October 1, 1999 solicited input from "stakeholders", including by asking the following:

> (a) Should eligibility be conferred only on employees who are directly involved in R&D activities, or should it be extended to include employees with less direct involvement in R&D activities?

(b) What level of R&D expenditure in Ontario, measured relative to revenues or costs, would be appropriate in order to be deemed an eligible corporation?

(c) What is the appropriate level of tax assistance under this credit?

The flavour of these questions implies that more precise determinations of available credit may not be possible until some later time.

STOCK PURCHASE PLANS

Rather than provide the employee with an option to purchase shares, the private company may establish a stock purchase plan, which is normally a plan made available to the employees at large. Often, under such a plan the employer offers to sell shares to employees on a regular basis at prices intended to equal the then-current fair market value of the shares. The basic economic advantage to the employee is essentially simply the opportunity to acquire shares (which opportunity would normally not be available, in the case of a private company, except for such plans or stock option plans or bonus plans). An economic disadvantage to the employee under a stock purchase plan, compared to a stock option plan, is that the employee pays for and acquires the share (at fair market value) and is from that point on exposed to drops in the fair market value of the share (usually, the employee must choose to purchase shares under the plan within a particular year or relinquish these rights, as opposed to a stock option plan where the employee pays usually nothing at the time the option is granted and then can choose to exercise or not depending on what happens to the value of the underlying share).

A stock purchase plan usually specifies a range of shares that may be purchased by an employee (minimum and maximum), and often by reference to salary or other objective criteria.

Where the employee purchases shares of the employer at fair market value, no taxable benefit to the employee arises, and the employee holds the shares normally as a capital property that is subject to capital gains tax on sale. Depending on the facts, the lifetime capital gains exemption may be available to shelter all or part of the gain.

In some cases, the employees contribute a percentage of their salary to a trustee who aggregates these amounts and applies them to the purchase of the shares. Notwithstanding that the employee's take-home pay is correspondingly reduced, the employee must pay tax on the full salary including the portion of the salary applied to the purchase of the shares, and the employer must make the full, normal source deductions on such salary. Source deductions may be reduced where permitted by Revenue Canada on a discretionary basis, for example, where the employee contributes the purchased shares to an RRSP. Contribution of shares of a private company to an RRSP involves other specific tax rules which are beyond the scope of this summary.

The employer will sometimes agree to sell shares under the plan at a slight discount to the assumed fair market value, or may to the some extent "match" the employee's salary used to purchase shares under the plan. In the case of shares issued at a discount, the employee would realize a taxable employment benefit equal to the discount, generally at the times and in the circumstances as described above in relation to stock option plans. In the case of a "matching" payment, the employee would be taxed on the contributions by the employer to the plan.

For the employer, the discount (if any) will in normal circumstances not be deductible, and any "matching" payment will normally be equally non-deductible, because of a special rule under the Tax Act denying employer deductions in circumstances where the employer's (otherwise deductible) "expense" arises under an agreement to sell or issue shares of the employer. In the case of a public company, it is sometimes possible for the employer to avoid this non-deductibility for "matching" contributions by an agreement whereby the trustee or administrator purchases the employer's shares for the employees in the open market (i.e., employer technically may not be selling or issuing its own shares), but this mechanism is usually unavailable to a private company.

Accordingly, and especially from the employer's perspective, a stock purchase plan by a private company that offers shares with a "matching" contribution should be approached carefully. On the other hand, the non-deductibility of the "matching" contribution may be viewed by the employer as having been offset in part by the issuance of the shares for cash.

STOCK BONUS PLANS

Under a stock bonus plan, the employee receives a bonus payable in the form of shares of the employer. The full fair market value of the shares (measured at the time of the issuance) is included in the employee's income, and the better interpretation is that this income inclusion arises only at the time the employee disposes of the shares (provided the company is a qualifying CCPC), and that the employer is denied a deduction for the benefit so conferred. Therefore, the employee may obtain a measure of deferral while the employer may consider itself advantaged through the non-cash outlay that takes the place of what might otherwise be a cash bonus.

Alternatively, the bonus may be paid not in the form of shares, but rather a cash bonus may be paid, the amount of which is tied in some way to the value or value increase of the company's shares. This type of plan is commonly referred to as a "phantom stock plan", in that no actual shares are issued. The general consequences to both employee and employer will be the same as on a payment of a cash bonus. Certain specific rules under the Tax Act must be carefully reviewed in the context of such a "phantom stock plan". For example, in order to avoid adverse characterization as a "salary deferral arrangement", it will generally be required to structure the phantom stock plan entitlement such that the entitlement has no present value at the time of grant (i.e. the bonus will be dependent upon increases in value to the share price). Additional issues arise under the Tax Act which make this type of plan potentially complex, certainly compared to the simple grant of a normal stock option.

No matter how a share-based incentive plan is structured, additional, special considerations under the Tax Act arise where the employer intends to offer related financing to the employee.

NEW EMPLOYMENT LAW
FOR THE HIGH-TECH INDUSTRY
IN BRITISH COLUMBIA

NEW EMPLOYMENT LAW FOR THE HIGH-TECH INDUSTRY IN BRITISH COLUMBIA

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In June, 1999, the British Columbia government relaxed some of the hours of work, statutory holiday pay, and overtime pay requirements of the *Employment Standards Act* for the high technology industry in the province. In doing so, the government has recognized the need to create more flexible workplace requirements to permit the high technology industry to be competitive.

The B.C. *Employment Standards Act* (the "*Act*") establishes minimum standards and requirements for employees in B.C. concerning minimum wage, vacation entitlement, statutory holidays, hours of work, overtime pay, pregnancy and other leaves, severance obligations, and other related matters.

The amendments to the *Act* exempt employees who meet the definition of a "high technology professional" from hours of work, overtime pay, and statutory holiday pay requirements, and also partially exempt certain other employees in "high technology companies" who do not meet the high technology professional definition.

WHO QUALIFIES AS A HIGH TECHNOLOGY PROFESSIONAL?

To qualify as a high-tech professional, an employee must meet the following criteria.

(a) be employed in one of the following occupations:

- (i) computer systems analyst
- (ii) manufacturing engineer
- (iii) materials engineer
- (iv) Internet development professional
- (v) computer programmer
- (vi) computer science professional
- (vii) multimedia professional
- (viii) computer animator
- (ix) software engineer
- (x) scientific technician
- (xi) scientific technologist
- (xii) software developer
- (xiii) software tester
- (xiv) applied biosciences professional
- (xv) quality control professional

(xvi) technology sales professional (other than a retail sales clerk)
(xvii) electronics engineer
(xviii) any other similarly skilled worker

(b) in addition to a regular wage, also receive stock options or other performance based compensation, the entitlement to which is set out in a written contract of employment.

(c) have one of the following qualifications:

(i) a baccalaureate or licenciature degree;
(ii) a related post-secondary diploma or certificate; or
(iii) equivalent relevant work experience.

If employees meet the above requirements to qualify as a high-tech professional, the following requirements of the Act will no longer apply to them:

(a) posting of hours - of-work notices.
(b) providing a one half hour meal break after five hours consecutive employment.
(c) requiring that a split shift be completed within 12 hours of starting work.
(d) providing minimum daily pay of 4 hours where the employee commences work, or 2 hours minimum pay where the employee reports for, but does not commence work.
(e) providing a minimum of 32 hours free from work each week.
(f) payment of overtime pay for hours worked in excess of 8 hours per day or 40 hours per week.
(g) payment of overtime pay or provision of a paid holiday for work performed on a statutory holiday.

WHO ELSE IS COVERED BY THE NEW LAW?

Obviously not all employees who work in the high technology industry will meet the definition of a high-tech professional. However, even those employees who are not high-tech professionals will be exempted from some of the provisions of the Act if they work for a "high technology company".

Under the *Act*, a high technology company is defined as one where more than 50 percent of the employees meet the definition of a high-tech professional (or manage high-tech professionals) or are employed in an executive capacity.

The following are the most significant changes to the Act which apply to employees who work for a high-tech company but do not meet the definition of a high-tech professional.

(a) instead of being entitled to overtime at the rate of 1.5 times their regular rate of pay after 8 hours per day and 2 times their regular rate of pay after 11 hours per day, the new requirement is entitlement to overtime pay at 1.5 times their regular rate of pay after 12 hours per day and after 80 hours in a two week period.

(b) instead of being entitled to overtime pay for a shift change on less 24 hours notice, the new requirement is an entitlement to at least 24 hours notice before being required to work additional hours beyond the end of a regular shift.

OTHER HIGH-TECH ORGANIZATIONS

High-tech organizations that do not fit the definition of a high technology company and employ persons that do not fit the definition of a high technology professional may still seek a variance under the Act concerning such matters as notice of shift change, minimum and maximum hours of work, and overtime wages. Variances may be granted by the Director of Employment Standards in certain instances where the variance is considered to be consistent with the intent of the *Act* and where advantages gained by the employees offset the loss of protection provided by the *Act*.

SUMMARY

The amendments to the Act affecting the high technology industry in British Columbia are both far-reaching and complex. Employers should refer to the Act and Employment Standards Regulation and seek legal advice.

METATAGS: WHAT YOU CAN'T SEE CAN KILL YOU

METATAGS: WHAT YOU CAN'T SEE CAN KILL YOU

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How to drive traffic to a web page is one of the biggest preoccupations of web-site designers. Without "traffic" or "hits" or "impressions" the web page might just as well not exist. Among the key tools used to generate traffic are Meta-tags. The selection of Meta-tag terms requires careful consideration not only to boost the web pages relevancy on search engine returns, but also to ensure that the organization is not exposed to legal claims.

There are several different kinds of Meta-tags. The most important Meta-tags for search engine indexing are the description and keywords tags. The description tag returns a description of the page in place of the summary the web page search engine would ordinarily create. The keywords tag provides keywords for the search engine to associate with your web page. Meta-tags do not appear on your web-page and it is not apparent to a visitor to your web page what Meta-tags are used.

A technique used in some web pages is create Meta-tag keywords that reference trade marks or names of competitors or competitors' products. For example, if you have developed new software which has comparable features to competitive established software, it may be tempting to use Meta-tag keywords that include the trade marks of the competitive software. Indeed, it is very easy to rationalize doing so. After all, your website may very clearly identify you as distinct from your competitor so that it is practically impossible for anyone to be misled into thinking that your software is that of your competitor. Another technique that is used is to use a Meta tag that is a common misspelling of the competitor's trade mark.

Recent case law from the United States suggests that you be wary of using competitors trade marks in Meta-tags. Brookfield Communications Inc. was the owner of the trade mark moviebuff.com. West Coast Entertainment registered a domain name moviebuff.com. Brookfield sought to enjoin West Coast from using the domain name and for fairly obvious reasons the court enjoined West Coast's use of the domain name. Brookfield also sought to enjoin West Coast from using "MovieBuff' and marks confusingly similar to "MovieBuff' in Meta-tags and buried code. The Court (US Court of Appeals, 9th circuit) determined that use of the "MovieBuff' trademark by West Coast in a Meta-tag would not result in source confusion in the sense that consumers know they are patronizing West Coast rather than Brookfield. However the Court also concluded that such use would result initial interest confusion because the use of "MovieBuff' in a Meta-tag would divert people looking for "MovieBuff' to West Coast's web site. By doing so West Coast would improperly benefit from the goodwill that Brookfield developed in its mark and accordingly, the Court issued a pre-liminary injunction. The Court agreed with earlier case law recognized that the use of another's trademark in a manner calculated to capture initial consumer affention, even though no actual sale is finally completed as a result of the confusion, may be still an infringement.

It is interesting to note that the Court would not have enjoined West Coast's use of the term "Movie Buff'. The term "Movie Buff' is a descriptive term; "MovieBuff' although differing by only a single space, is not. The Court also expressly acknowledged that West Coast was not absolutely barred from using the word "MovieBuff' in its website. West Coast could use the word "MovieBuff' provided that its use fell within the doctrine of fair use. Fair use might include a reference to the "MovieBuff' products such as "Why pay for MovieBuff when you can get the same thing here for FREE?"

The damages for trade mark infringement can be substantial. Perhaps even more relevant is the remedy of injunction (a preliminary injunction issued in the Brookfield case). An injunction can result in closure of your web site and can be fatal to a business that depends on e-commerce. The lessons include: be careful of the risk of trade mark infringement in selecting Meta-tags; use Meta-tags and keywords that are not trade marks (or misspelling of trademarks) as a shotgun approach to developing site awareness, and consider "fair use" of competitor's trade marks in the web-site text (which is searched by some engines) rather than in Meta-tags.

INTERNET DOMAIN NAMES

Dawn of a New Era or Just More Fog?

INTERNET DOMAIN NAMES?
Dawn of a New Era or Just More Fog?

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If your eyes haven't yet glazed over trying to decipher the proliferation of acronyms involved in the efforts to establish a new domain names system for the Internet, you may be one of the few who have been able to follow this never-ending saga. With the risk of losing readers in a fog of abbreviations, it is useful to try and summarize what has occurred to date and where we appear to be going.

The Internet Domain Name System (DNS) links web sites to Internet Protocol (IP) addresses thus allowing users access to a site by simply typing into their computer a combination of letters and punctuation marks. The DNS has, since its inception, been administered by the Internet Assigned Numbers Authority (IANA), a U.S.-based non-governmental organization created 20 years ago by the late Dr. Jon Postel. IANA is responsible for allocating Internet-Protocol (IP) numbers for all domain registries throughout the world. Currently, there are 249 country code top level domains (or ccTLDs) such as .ca, .us and .eg (Egypt), to which are registered about 1.4 million names. In contrast, there are only seven "generic top level domains" (or gTLDs) to which are registered approximately 3.4 million names. By far the great majority of these names are registered in the three "open" gTLDs, being .com, .net and .org which, because they are open to any class of registrant, are the only ones of real commercial interest to businesses.

In order for the system to work, it is essential that there be no inconsistency or duplication of domain names anywhere in the Internet world. Arising out of the Internet's U.S. origins, IANA has, to date, performed the role of assuring this requirement. As part of this framework and as a significant step in the commercial development of the Internet, U.S.-based Network Solutions Inc. (NSI) was, in 1992, granted sole authority by the U.S. Government to develop and administer a registration system for gTLDs. Since then, at US$70 per name, NSI has done very well by this business.

However, NSI's monopoly as sole registrar is winding down. For the past three years, various policy papers and other initiatives have been focused on broadening the registrar base. As a result, NSI was directed to open up its lucrative register and is currently establishing a test framework to technically support newly accredited gTLD registrars. In April of this year, IANA's successor as overall domain name administrator, the Internet Corporation for Assigned Names and Numbers (ICANN), announced the names of five companies selected to participate in an initial two month testbed of the new competitive Shared Registry System for the .com, .net & .org domains. Following conclusion of this testbed the Shared Registry System will be opened on equal terms to all potential registrars who meet ICANN's standards for accreditation.

Critical however to the appointment of new gTLD registrars is a system for resolving conflicts between domain names and traditional intellectual property rights (primarily trade marks). Legal issues involving the interface between domain name registrations and established trade mark rights have been at the centre of much of the dissatisfaction with the current system. For example, there have been problems with persons registering well-known trade marks as domain names without the authorization of the owner of the mark. Consequently, the World Intellectual Property Organization (WIPO) was requested to make recommendations to ICANN for a dispute resolution mechanism, as well as for a system for protecting famous trade marks as gTLDs. In December 1998, WIPO brought forward its recommendations in an Interim Report and, after soliciting comments through consultation sessions around the world, has now presented its Final Report for implementation by ICANN.

The above overview might suggest that the Internet world is rationally and methodically moving toward a more open and competitive domain name regime, with clear protection for owners of legitimate trade mark and other intellectual property rights. However, the final framework is far from settled and much heated debate continues.

Criticism of ICANN and the authority that it claims have been voiced by members of the U.S. Congress as well as by NSI, the party with the most to lose in any new regime. This past February, NSI issued a strong statement asserting that the interim ICANN board “does not possess the authority or mandate to promulgate the global Internet governance administration portrayed in its Accreditation Guidelines”. The Guidelines, says NSI, present “a fait accompli blueprint for a complete global Internet governance, complete with imposed policies, management of businesses, licensing, and taxation, that wouldn’t be contemplated today even for the most highly regulated telecommunications carriers. This is a radical departure from what was intended or expected after the past 18 months of public policy making procedures and findings, and profoundly discordant with all the existing agreements and expectations for ICANN.”

NSI maintains that the proposed regulatory administration is wholly at odds with the historically distributed, cooperative basis for the Internet, and institutes “a heavy-handed global regulatory administration and corresponding bureaucracy never envisioned in any of the prior multi-year policy debates.” Nonetheless, NSI is being pushed (or pulled), protestations notwithstanding, into this new world of competitive domain name registration.

The dispute resolution system that will operate in this new world is also subject of controversy and, if not settled, could delay the whole process. WIPO’s proposals have elicited vociferous criticism from some quarters. Prominent among the critics is Internet legal guru Michael Froomkin, a professor of law at the University of Miami.

The essence of WIPO’s proposals is that all future registrants of TLDs would be required to enter into an agreement, setting out the terms of their registration including acceptance of a prescribed arbitration procedure. Such a procedure would enable existing trade mark owners to challenge any new domain name registrations that are abusive of their established rights. In addition, the WIPO proposals would grant the owners of currently existing well-known trade marks an exclusive right to domain name registrations throughout the Internet.

Professor Froomkin sees the WIPO proposals as biased in favour of trade mark owners, imposing a whole new set of legal rules over and above existing trade mark law which he believes should continue to be the foundation for name protection and rights. He also believes that, if adopted, the proposals may limit freedom of expression (by expanding the potential bases for challenge to new domain names), and entail serious risks to registrants' privacy. In summary, he sees the proposals as creating a host of new rights for trade mark holders and only greater potential liabilities for domain name registrants.

Domain names have become to e-commerce what trade marks are to more traditional product marketing. However it is critical for the growth and ultimate convergence of today's marketplace that the two systems have a coherent interface that is fair to all parties. It remains to be seen whether the new framework will achieve this objective.

TSE ORIGINAL LISTING REQUIREMENTS FOR INDUSTRIAL AND RESEARCH & DEVELOPMENT COMPANIES

TSE ORIGINAL LISTING REQUIREMENTS FOR INDUSTRIAL AND RESEARCH & DEVELOPMENT COMPANIES

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In 1998, The Toronto Stock Exchange (the "TSE") made significant alterations to the listing requirements in each of its listing categories: mining, industrial and oil & gas. These changes are aimed at increasing the standards which companies must meet in order to obtain a listing on the TSE. Generally, financial requirements for all categories have been increased, and the requirement to obtain sponsorship has been given increased importance through the mandating of specific review practises to be followed by the sponsor.

The following is a detailed discussion of the listing criteria for industrial companies and a subset thereof, research and development companies. Information technology companies will fall into the industrial category and may, in certain cases, also be considered under the research and development category.

INDUSTRIAL COMPANIES

Financial Requirements

Industrial companies (other than Research and Development Companies, which will be discussed later) will be required to have, in addition to adequate working capital and an appropriate capital structure, either:

> (a) for profitable companies: net tangible assets of $2 million, pre-tax earnings from ongoing operations of $200,000 and pre-tax cash flow of $500,000 in the preceding fiscal year (the previous requirements were $1 million, $100,000 and $400,000, respectively); or
>
> (b) for companies forecasting profitability: net tangible assets of $7.5 million (an increase from $5 million), evidence satisfactory to the Exchange of pre-tax earnings from operations of at least $200,000 and pre-tax cash flow of $500,000, in each case for either the current or the next fiscal year.

* This paper has been prepared by Stephen D. Wortley and Leo Raffin and is based on papers that have been previously written by various members of the securities practice groups in the Vancouver and Toronto offices of Lang Michener Lawrence & Shaw.

Companies with less than $2 million in net tangible assets may still qualify for a listing if they meet the earnings and cash flow thresholds described below for companies seeking an exemption from section 19.09 of the TSE general by-law.

For companies seeking a listing on the basis of forecasted profitability, the TSE will generally require (a) the filing of a complete set of forecasted financial statements (prepared on a quarterly basis) covering, as applicable, the current or next fiscal year, and an independent auditor's opinion that the forecasted financial statements comply with the CICA Auditing Standard for future oriented financial information, (b) that the company have at least six months of operating history, and (c) that in its most recent six months, the Company have gross revenues at commercial levels. Also for these companies, the TSE may, in its discretion, permit the inclusion of deferred development charges or other intangible assets in the calculation of net tangible assets

Companies seeking exemption from section 19.09 of the TSE general by-law (and among other things, exemption from the sponsorship requirements described below) will require adequate working capital and capitalization, net tangible assets of $7.5 million, pre-tax earnings of $300,000 and pre-tax cash flow of $700,000 in the preceding year and average pre-tax cash flow of $500,000 for the two preceding fiscal years.

Management

Management is explicitly required to have adequate experience and technical expertise relevant to the business of the company as well as adequate public company experience. A minimum of two Canadian directors will be required for non-foreign companies.[1]

Public Distribution

The applicant company will be required to have at least 1,000,000 freely tradable shares held by at least 300 public board lot holders (generally, a board lot consists of 100 shares) having an aggregate market value of at least $4 million (an increase from $2 million).

Sponsorship

All companies seeking listing in the industrial category, except for those that qualify for an exemption from section 19.09 of the TSE general by-law, must be sponsored by a TSE member firm. The responsibilities of sponsoring members have been significantly expanded such that sponsors are now required to review and comment on:

(a) the listing application and submitted materials as well as the applicant's ability to meet the listing requirements;

(b) any future oriented financial information submitted with the application;

(c) the applicant's business plan;

(d) the press releases and financial disclosure of the applicant during the past year; and

(e) the experience and expertise of management relevant to the business of the applicant and on the past conduct of the applicant company's directors, officers and principal shareholder.

In addition, a sponsor firm must advise whether the sponsor has visited or inspected the principal facilities or offices of the candidate company.

RESEARCH AND DEVELOPMENT COMPANIES

The TSE has adopted, for the first time, a specific set of listing requirements for companies whose business is at the research and development stage (the "R&D Category"). As the criteria for industrial issuers requires a company to have ongoing commercial (profitable) operations, or a near term likelihood of achieving such operations, most early knowledge-based companies (such as life sciences companies) who wish to seek a listing on the TSE will need to satisfy the listing criteria in the R&D Category.[2]

The adoption by the TSE of specified criteria under the R&D Category codifies a number of non-published practices utilized by the TSE in reviewing listing applications for companies which did not meet the specified criteria for industrial issuers.

Capitalization

The company should have a minimum of $12 million in its treasury, the majority of which has been raised by the issuance of securities qualified for distribution by a prospectus.

Adequacy of Financial Resources

The company should have adequate funds to cover at least two years worth of planned research and development expenditures, general and administrative expenses and any proposed or required capital expenditures.

Operating History

The company should have a minimum two year operating history that includes research and development activities.

Sufficient Resources

The company must provide evidence, satisfactory to the TSE, that it has the technical expertise and resources to advance the company's research and development programs. Under this general requirement, the TSE will consider all relevant factors including:

(a) the stage of development of the company's products or services and the prospects for commercialization;

(b) commercial or technical endorsements of the company's products or services from recognized academic institutions or industrial participants;

(c) existing or potential markets for the company's products or services and the marketing infrastructure and sales support necessary to service these markets;

(d) background and expertise of management including its record of raising funds to finance research and development projects and ongoing operations;

(e) evidence and composition of any scientific advisory board; and

(f) the existence of affiliations with major industrial enterprises or strategic partners.

Sponsorship

Strong sponsorship from a TSE member firm is required.

Public Distribution

Issuers qualifying under the R&D Category must still meet the standard public distribution test of 1,000,000 freely tradable shares having an aggregate market value of $4 million that are held by at least 300 public holders, each holding at least one board lot.

General

To demonstrate that it has sufficient capital resources to support at least two years of operations, a company will be required to provide the TSE (for its use only and on confidential basis) with a projection of sources and use of funds covering the period (prepared by quarter). Generally, the projection should exclude cash flows for future revenues, uncommitted payments from third parties or other contingent cash receipts. The projection need not take the form of a financial forecast (a document required to be filed for industrial companies seeking a listing on the basis of forecasted profitability) and need not be reported on by the company's auditors.

As with any application for listing, the TSE retains the discretion to take into account any other factors it considers relevant in reviewing the application. Such circumstances may result in the TSE approving a listing which may not meet all of the stated qualifications, or denying a listing which otherwise meets the stated criteria. As the listing criteria for companies in the R&D Category contains a greater subjective element than issuers seeking to qualify under the general industrial company category, issuers seeking a listing in the R&D category are encouraged to undertake steps to ensure the acceptability of the company for listing on the TSE well in advance of filing a listing application. Such steps should include consulting with experienced corporate finance counsel or other financial advisors and utilizing the TSE's Original Listing Advisory Service (based on review of financial information and the description of the company's activities, the TSE will provide a confidential preliminary opinion as to eligibility for listing).

The TSE's minimum listing criteria in the R&D Category form part of most guides utilized by market analysts to determine the investment potential of life sciences, hi-tech or other knowledge based companies. However, while meeting the specified listing requirements under the R&D Category may permit a company to obtain a listing on the TSE, to approach the planning of a listing (and any concurrent share offering) solely on the basis of satisfying these minimum listing requirements, in most cases is not a prudent corporate finance strategy. For example, a two year cash reserve (interestingly, this is lower than the previous unwritten policy of requiring a three year reserve) may, depending upon the company's stage of development, limit corporate planning and expose the company to significant financial risk depending upon market financing cycles. The life sciences industry has demonstrated that it is generally susceptible to a capital raising cycle in the public markets that is characterized by relatively short windows of financing opportunity and long periods where such financing windows are closed for all but the most well established companies. Identifying the expectations the participants in the financial markets have regarding the quality of the essential elements a company should possess before seeking a listing or access to the public capital markets (e.g. breadth of technology platform, strength of intellectual property position, extent of its financial resources and expertise and experience of management), is a key undertaking a company should seek to complete as part of its corporate finance planning.

Identifying these additional criteria (e.g., an affiliation with a larger strategic partner is preferred), would be the duty of the chief executives of the company.

CONCLUSION

While the foregoing amendments generally represent a move by the TSE towards more stringent standards in an effort to distinguish itself from the "junior exchanges" and emulate the likes of the New York Stock Exchange and Nasdaq, the TSE is quick to point out that the improved standards, if applied to companies listed over the past five years, would have resulted in non-compliance by only a small percentage of the companies listed during that period. If this was mostly due to "marginal" companies (those which just met the TSE's financial or other key operating criteria) avoiding a listing until they were better positioned financially or their business more advanced, we may see a slowing in number of listings and an even greater increase in quality.

Over the next few years, participants in the relevant industries will need to monitor whether the higher listings standards significantly affect the quality of listings and their number. Also of interest will be the affect the TSE's standards have on the ability of companies to migrate from more junior or venture oriented exchanges, such as the to be formed national venture exchange (the combined VSE/ASE), to the TSE. If issuers are required to spend a longer time maturing on a venture exchange before they seek to move to the TSE, this may pose a challenge to the venture exchange to provide an appropriate environment to foster the longer-term development of early stage enterprises. Investors operating in the venture markets well understand the benefits and risks associated with natural resource issuers, but are only recently coming to grips with technology enterprises. Failure of the new venture exchange to provide an appropriate market environment for technology driven enterprises may provide an opportunity for its U.S. based exchanges to attract these companies before they attain a size that is suitable for listing on the TSE.

Finally, an additional matter which will need to be monitored is the affect the mandating of sponsors' duties has on the willingness of the investment banking community to sponsor more junior companies. It may be argued that the standards now imposed by the TSE for sponsorship letters merely embody many of the items previously reported on in such letters, particularly those provided in the context of a listing application combined with an offering. In this light, the new rules are a mere codification of "good practice". By standardizing these requirements, however, the TSE is compelling all sponsors to incur the same liability risks, in all cases, with the result that in certain circumstances, especially in the context of listing applications without concurrent offerings, sponsors may be reticent to take these risks. Admittedly, preserving the balance of maintaining adequate controls to achieve consumer protection policy objectives without imposing prohibitive requirements on legitimate applicants is difficult; however, one hopes that the new requirements and reliance on "due diligence" by sponsoring members will achieve the objective of "weeding out" undesirable applicants, without having raised the bar so high that *bona fide* candidates will be deterred from seeking listing on the TSE. By mandating the activities to be carried out by sponsors, the TSE is requiring them to assume significant due diligence obligations. This may result in both a reticence to put forward new issues and result in higher sponsoring for applicant companies.

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[1] There is no specific definition of a "foreign company". For companies wishing to list on the TSE, TSE officials consider whether a company should meet "foreign requirements" based on location of incorporation, location of head office, location of operations and majority of revenues, location of shareholder base, where the principal market for trading in the security is and will be if there is to be a dual listing, will the TSE be the sole market for the securities, and whether the securities will be RRSP eligible. Foreign listing criteria are more onerous than they are for domestic issuers. However, with respect to mining and exploration companies applying to list on the TSE, the TSE would provide special "provisions" allowing such companies to qualify under domestic criteria, regardless of head office, jurisdiction of incorporation, location of projects, etc.

[2] The TSE has not developed a definition of a Research & Development Company.

ELECTRONIC COMMUNICATIONS AND DISCLOSURE

TSE Rules and Guidelines

ELECTRONIC COMMUNICATIONS AND DISCLOSURE
TSE Rules and Guidelines

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In August 1998, the Toronto Stock Exchange ("TSE") published for comment a set of rules and guidelines relating to the use by publicly listed companies of electronic means to disseminate information to investors. These rules and guidelines are aimed at companies which maintain websites on the Internet and attempt to establish standards which companies must adhere to in connection with the dissemination of timely information.

The Internet holds potential as an effective method of disseminating information to investors in a timely and accessible manner. The TSE acknowledges the potential benefit of the use of the Internet and has recommended that all listed companies maintain a corporate website to disseminate investor relations information. However, failure by companies to maintain and update their websites can result in the circulation of misleading information in the marketplace. The TSE is of the opinion that all electronic communications are subject to securities laws and should not be viewed solely as a promotional tool. Companies which have a website should refer to the TSE Policy Statement on Timely Disclosure and Related Guidelines as well as all other relevant policy pronouncements to ensure that their websites are in compliance with these policies. In addition, the TSE has established a rule that companies review their websites on an ongoing basis and revise any outdated information and correct any misleading or incomplete information.

Providing incomplete information or omitting a material fact is considered to be misleading. The TSE requires that a company include on its website all material information that is required by law to be disclosed and that documents be posted in their entirety. A company should also post all supplementary information provided to investment analysts and large investors (companies are reminded that there are limits on the nature of information that can be disclosed to these parties if there is no concurrent public disclosure). Before releasing material news on its website, a company must release the news through a newswire service.

The TSE encourages companies to establish their own corporate disclosure policies regarding electronic dissemination of information. In addition, the TSE recommends that one or more officers appointed under a company's disclosure policy be made responsible for the company's policies on electronic communications. The corporate disclosure policy should also include procedures on how the company is to address and correct rumours in the marketplace. The TSE suggests that once a company becomes aware of a rumour which may influence trading in the company's securities, it should contact the TSE's market surveillance department and, if appropriate, issue a corrective press release.

The TSE suggests that companies consult with legal advisors with respect to the contents of their website, since the provision of information over the Internet raises several securities law issues, in particular with respect to advertisement and pre-solicitation rules, and cross-border dissemination. In addition, a company may wish to discuss with counsel the form of any disclaimers which should be included on the website, for example with respect to the timeliness and completeness of the information contained on the website or information provided by third parties as a result of the company maintaining a hyperlink to a third party's site. The TSE guidelines also caution issuers with respect to posting of analysts reports.

The TSE guidelines are important not only because of their regulatory implications but also because of concerns about liability for issuers and their officers and directors. In this respect, issuers should be mindful of the recent proposal of Canadian Securities Administrators for a statutory remedy for investors in the secondary market. Any misrepresentation contained in information placed on an issuer's website may give rise to liability. This proposal is discussed in Mr. Tardif's commentary, "Proposal for a Civil Statutory Remedy for Investors in the Secondary Market," which is included in these briefing notes.

PROPOSAL FOR A CIVIL STATUTORY REMEDY FOR INVESTORS IN THE SECONDARY MARKET

PROPOSAL FOR A CIVIL STATUTORY REMEDY FOR INVESTORS IN THE SECONDARY MARKET

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The Ontario Securities Commission (the "OSC") and other members of the Canadian Securities Administrators have published for comment draft legislation (the "Proposal") that would establish civil liability for continuous disclosure documents disseminated in Canada. The Proposal, once adopted, would implement the main recommendations contained in the March 1997 Report of the Toronto Stock Exchange Committee on Corporate Disclosure.

Implementation of the Proposal will require an amendment to the securities legislation in each province. The intention is to create the same right of action in all Canadian jurisdictions. Under the Proposal, investors who trade in securities of an issuer (other than a private issuer) on the secondary market will have similar rights of action to those who purchase securities in the primary market (i.e., new issues).

In its notice dated May 29, 1998, the OSC summarized the objective of the Proposal as follows:

(a) The objective of the Proposal is to create a meaningful civil remedy for investors who trade in the secondary market when there is a failure to make timely disclosure, or when there are misrepresentations in continuous disclosure documents and oral statements issued by or on behalf of issuers and other responsible persons. At the same time, the Proposal imposes reasonable limitations on potential liability for continuous disclosure misrepresentations to address concerns about opening the door to the type and extent of securities class actions experienced in the United States.

(b) To achieve this objective, the Proposal provides that if an issuer releases a document which contains a misrepresentation, any person who buys or sells securities before such misrepresentation has been corrected has a right of action for damages against the issuer and its directors as well as certain officers and shareholders.

(c) While imposing liability for misrepresentations in continuous disclosure documents, the Proposal seeks to address concerns about the "strike suits" experienced in the United States by imposing certain limits on possible damage awards and by mandating a "loser pays" approach to litigation costs.

The following is a summary of the Proposal.

CIRCUMSTANCES WHICH GIVE RISE TO LIABILITIES

Under the Proposal, liability for damages will arise in the following circumstances:

(a) where an issuer releases a document that contains a misrepresentation;
(b) where a person with authority to speak on behalf of an issuer makes a public oral statement that relates to the issuer and that contains a misrepresentation;
(c) where an influential person1 releases a document or makes a public oral statement that relates to the issuer and that contains a misrepresentation; or
(d) where an issuer fails to make timely disclosure of a material change.

A misrepresentation is defined in the Securities Act (Ontario) to mean "an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made." The Proposal adopts a new definition of a "material fact" which provides that a fact is a material fact if it is substantially likely to be considered important to a reasonable investor. The definition of "material fact" would no longer provide that a fact is a material fact if it can reasonably be expected to have a significant effect on the market price or value of the securities.

WHO HAS A RIGHT OF ACTION?

Under the Proposal, a person or company (the "plaintiff") who acquires or disposes of a security of the issuer (including a derivative security created on behalf of or guaranteed by the issuer) will have a right of action for damages. This includes acquisitions and dispositions made between the time when the document was released, an oral statement was made, a material change was required to be disclosed and the time when the misrepresentation was corrected (or a material change was disclosed).

WHO IS LIABLE?

Under the Proposal, the following persons (the "defendants") will be liable to a plaintiff for damages in respect of a misrepresentation or failure to disclose:

In the case of a core document2 released by the issuer or influential person:

(a) the issuer;
(b) each director of the issuer;
(c) each officer who authorized, permitted or acquiesced in the release of the document;
(d) each influential person (or director or officer thereof) who knowingly influenced the release of a document released by the issuer or who authorized, permitted or acquiesced in the release of a document released by a influential person; and
(e) an expert whose report or opinion is quoted in the document.

In the case of a non-core document3 released by the issuer or an influential person:

(a) the issuer;
(b) an expert whose report or opinion is quoted in the document; and
(c) all other possible defendants described above, but only if the plaintiff proves that the defendant was aware of the misrepresentation, deliberately avoided acquiring relevant knowledge or was grossly negligent.

In the case of public oral statements made by the issuer or influential person:

(a) the issuer;
(b) the person who made the statement;
(c) an expert who consents to be quoted in the statement; and
(d) directors and officers of the issuer or influential person who permitted or acquiesced in the making of the statement, but only if the plaintiff proves that the defendant was aware of the misrepresentation, deliberately avoided acquiring relevant knowledge or was grossly negligent.

In the case of a failure to make timely disclosure:

(a) the issuer; and

(b) directors and officers of the issuer, each influential person or each director or officer of an influential person who permitted or acquiesced in the failure to make timely disclosure if the plaintiff proves that the defendant was aware of the failure to make timely disclosure, deliberately avoided acquiring relevant knowledge or was grossly negligent.

Liability would not only arise when an issuer or influential person releases a document or makes a public oral statement, but also where "a person with actual, implied or apparent authority to act on behalf" of such issuer or responsible person releases such document or makes such a statement.

AMOUNT OF LIABILITY

Under the Proposal, the amount of damages recoverable by a plaintiff cannot exceed the amount of the actual loss. The total liability for an issuer for a misrepresentation cannot exceed the greater of five per cent of the issuer's market capitalization or $1 million. The total liability for a director or officer is limited to the greater of $25,000 or 50 per cent of the director's or officer's total compensation from the issuer during the previous 12 months. Moreover, the total liability for an expert cannot exceed the greater of $1,000,000 and revenue earned from the issuer during the previous 12 months. In circumstances where multiple defendants are found liable, each defendant's liability will be proportionate.

Notwithstanding the “caps” described above, the liability of a defendant (other than the issuer) is not limited where such defendant “authorized, permitted or acquiesced” in the making of the misrepresentation.

The costs of any proceeding will be awarded to the prevailing party by the court in accordance with applicable rules of civil procedure. Such rules typically limit the award of costs to an amount which is significantly lower than actual costs borne by the litigants.

DEFENCES

The Proposal codifies the following defences which would be available to a defendant:

Due Diligence Defence

A defendant (including the issuer) is not liable if it establishes that it conducted or caused to be conducted reasonable investigation and had reasonable grounds to believe that there was no misrepresentation (or failure to make timely disclosures).

Knowledge or Causation

A defendant (including the issuer) is not liable if it establishes that the plaintiff was aware of the misrepresentation or that the misrepresentation did not cause the loss.

Corrective Action

A defendant (including the issuer) is not liable for the loss which is incurred after corrective action is taken by the defendant if the misrepresentation was made without the knowledge of the defendant and the defendant promptly notified the board of directors of the issuer and, in certain circumstance, the OSC.

Forward-Looking Information

The Proposal adopts a similar approach to recent U.S. reforms in the area of securities litigation by providing a defence to a defendant in respect of misrepresentations contained in forward-looking information if such information contains cautionary language and the conclusions were reasonable.

CONCLUSION

The implications of the Proposal are far-reaching. Issuers will have to consider what processes need to be implemented to ensure the control and verification of information released into the public domain and to ensure all possible defendants are given an opportunity to make reasonable investigation with respect to any public document. Moreover, issuers will have to consider carefully the use of documents which are not mandated by securities legislation but which may be distributed to prospective investors (e.g., confidential information memorandum) and the practice of briefing securities analysts.

The Proposal, once it becomes law, together with class proceedings legislation, will remove many of the procedural and evidentiary hurdles which plaintiffs historically have faced when considering litigation in respect of misleading public disclosure.

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