

LEGAL DEVELOPMENTS AFFECTING ONLINE CONTRACTS IN THE UNITED STATES

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Online contracts are now as enforceable as traditional, ink-signed, paper contracts in the United States especially since the passage of the E-Sign Act and the Uniform Electronic Transaction Act (“UETA”).² Consumers are protected from potential abuses through an electronic signature as certain types of legal documents and contracts, like wills and notices of termination of insurance benefits, are exempted from the E-Sign Act. Online contracts, including the digital version of an acceptance signature, are now commonly used and are critical to the development of global e-commerce in the 21st century.

The United States has continued its legal developments in both legislation and case law regarding online contracts, which further define the scope and elements of electronic contracting that is key to our increasing development of e-commerce. There was a federal anti-spam law passed which preempts state spam laws. There is a state of flux in the area of privacy and information security. There is an ongoing debate about the removal of the temporary restraint on online taxation. There were case law developments for online contracts in the acceptance of online contracts, jurisdiction or “choice of law” clauses and arbitration provisions. A few of these developments will be discussed below.

I. CASE LAW DEVELOPMENTS

A. Basic Elements

Online contracts, like any paper contract, must include the three essential elements of a contract: offer, acceptance and consideration. The “offer” element is essentially the goods or services offered online. The “consideration” element in online contracts is the value (i.e. money) contributed. The most significant case law and legislative developments on the enforceability of online contracts have been over the “acceptance” element. Even before the advent of the E-Sign Act, internet companies had created new and unique ways of establishing a customer’s acceptance of their offer in the online contract. There are “I Agree” buttons, boxes to be checked next to a link for terms

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² The Millennium Digital Commerce Act, also known as the Digital Signatures or E-Sign Act, was enacted on June 30, 2000. Even prior to the E-Sign Act, the Uniform Electronic Transactions Act, as the model legislation for states, had been enacted in the majority of states to accept electronic signatures as valid and binding.

and conditions, and even presumed acceptance if the customer took some action that manifested the requisite assent (e.g. downloading software, conducting a WHOIS query, or completing an application form with a form of electronic signature.) In the last five years, the courts have established several rules of law that a party has accepted the online contract's terms and conditions. See, *I.LAN Systems, Inc. v. NextPoint Networks, Inc.*, 183 F.Supp.2d 328 (D. Mass. 2002) (an "I Agree" button manifested the party's intent to accept the contract terms); *Groff v. America Online, Inc.*, 1998 WL 307001 (R.I. Super. May 27, 1998) (same); *Register.com, Inc. v. Verio, Inc.*, (use of WHOIS query was conduct manifesting the requisite assent); see, however, *Ticketmaster Corp., et al. v. Tickets.com, Inc.*, 54 USPQ2d 1344 (C.D. Cal. 2000) (without an affirmative action like clicking on an "I Agree" button some other form of acceptance was required)³; and *Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. 2002) (acceptance of inconspicuous terms and conditions is ambiguous and unenforceable where the terms were in a screen below the "download" button).

While online contracts take many forms, three of the most common are: "Click-Through Agreements;" "Terms of Use;" or "Shrink Wrap Agreements." Despite their form, these electronic agreements still need to comply with the three basic elements of a contract. The distinctions between these forms have led to developments in case law specific to each type of form. See *Caspi v. Microsoft Network L.L.C.*, 732 A.2d 528 (N.J. Super. 1999) (subscriber had an opportunity to review and affirmatively indicated assent by clicking on the "I Agree" button); *In re RealNetworks Inc. Privacy Litigation*, 2000 WL 631341 (N.D. Ill. 2000) (an agreement appearing on the computer screen was a "writing" sufficient as long as it was easily printed and stored); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (agreement enforceable as long as existence of the agreement is disclosed on the outside of the box and consumer is given reasonable opportunity to return the product); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (*ProCD* logic extended to telephone sales of computers even when box did not disclose existence of the agreement.)

B. Jurisdiction

Even when an online contract has been validly formed via the three main elements, there are often other conflicts, which have led to additional legal developments in case law. One fight that becomes even more significant in online contracts is the jurisdiction or venue for any litigation that may arise out of the contract. The internet allows global access, but also the possible risk of global jurisdiction if there is no jurisdiction or forum selection clause in the online contract. For example, in *Gator.com Corp., v. L.L. Bean, Inc.*, 341 F.3d 1072 (9th Cir. 2003), the Ninth Circuit found general jurisdiction based on both the "continuous and systematic contacts" test and the "sliding scale" test. The Court noted: "It is increasingly clear that modern businesses no longer

³ In subsequent proceedings Ticketmaster was able to prove that Tickets.com was aware of its conditions of use, but the District Court in the Central District of California noted that "clear unmistakable evidence of assent to the conditions on trial of such issues, the court would prefer a rule that required an unmistakable assent to the conditions easily provided by requiring clicking on an icon which says "I agree" or the equivalent." *Ticketmaster Corp., et al. v. Tickets.com, Inc., et al*, 2003 WL 21406289, *2 (C.D. Cal. 2003) (not selected for publication in the federal reporter.)

require an actual physical presence in a state in order to engage in commercial activity there. With the advent of ‘e-commerce,’ businesses may set up shop, so to speak, without ever actually setting foot in the state where they intend to sell their wares. Our conceptions of jurisdiction must be flexible enough to respond to the realities of the modern marketplace.” *Id.* at 1081.⁴

General jurisdiction exists when there are “substantial or “continuous and systematic” contacts with the forum state, even if the cause of action is unrelated to those contacts. *Bancroft & Masters, Inc. v. Augusta Nat’l Inc.*, 223 F.3d 1082, 1086 (9th Cir. 2000) (citing *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 415 (1984).) “[C]ourts have focused primarily on two areas. First they look for some kind of deliberate ‘presence’ in the forum state, including physical facilities, bank accounts, agents, registration, or incorporation. . . . In addition, courts have looked at whether the company has engaged in active solicitation toward and participation in the state’s markets, i.e., the economic reality of the defendant’s activities in the state.” *Gator*, 341 F.3d at 1077. The *Bancroft* case held that the Internet presence in the state was passive and not directed at the state so no general jurisdiction was found. The *Gator* court held L.L. Bean’s internet presence was directed at California and the interaction with California consumers was consistent, ongoing and a sophisticated sales effort. *Id.* at 1078.

The “sliding scale” test has been used in assessing whether an internet presence is sufficient to find general jurisdiction. See *Cybersell, Inc. v. Cybersell, Inc.*, 130 F.3d 414, 419 (9th Cir. 1997). “This test requires both that the party “clearly do business over the Internet,” *Zippo Mfg. Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997), and that the internet business contacts with the forum state be substantial or continuous and systematic. See *Revell v. Lidov*, 317 F.3d 467, 470-71 (5th Cir. 2002); accord *Coastal Video Communications Corp. v. Staywell Corp.*, 59 F. Supp. 2d 562, 571 (E.D. Va. 1999).” *Gator*, 341 F.3d at 1079. (footnote omitted.) See also *Gorman v. Ameritrade Holding Corp.*, 293 F.3d 506, 512-13 (D.C. Cir. 2002); and *ALS Scan, Inc. v. Digital Serv. Consultants, Inc.*, 293 F.3d 707, 713-15 (4th Cir. 2002). However, the Eighth Circuit has limited the “sliding scale” test as being appropriate in cases dealing with specific jurisdiction looking only for “minimum contacts”. *Lakin v. Prudential Securities, Inc.*, 348 F.3d 704, 711 (8th Cir. 2003). The Eighth Circuit continued that the general personal jurisdiction consideration needs to view the “sliding scale” as only one factor in a three factor review: quantity of the contacts; nature and quality of the contacts; and the source and connection of the cause of action with those contacts. *Id.* See also, *Hy Cite Corp. v. BadBusinessBureau.com, L.L.C.*, __ F.Supp.2d __, 2004 WL 42641 (W.D. Wis. 2004) (holding that the “sliding scale” is not conclusive but merely one factor to be considered in determining personal jurisdiction.)

Forum selection clauses are generally enforced under United States contract law and this is true even in an online contract. *Freedman v. American Online, Inc., et al*, __

⁴ This concept isn’t even a new one. See *Hanson v. Denckla*, 357 U.S. 235, 250-251 (1958) (recognizing that technological progress may require evolution of the personal jurisdiction requirements, but do not eliminate the requirement for “minimal contacts” with the forum state.)

F.Supp.2d ___, 2003 WL 22900942 (D. Conn. Dec. 05, 2003) (No. Civ.3:03CV1048 (PCD)) (forum selection clause in online membership agreement is valid and enforceable absent a claim of “‘exceptional’ circumstances in which the forum selection clause should not be enforced because it is unreasonable.”) *Id.* at *2. *See, however, America Online, Inc. v. Superior Court*, 90 Cal. App. 4th 1 (2001) (held forum selection clause contravenes California public policy.) The consumer may fight the validity of this type of clause as being unreasonable or against public policy. The consumer may even challenge the validity of the contract as a whole depending on the evidence available for showing all three basic elements have been met, especially acceptance.

Even the traditional concept of a contract made directly between the two parties has been modified slightly in online case law as an intermediary may be deemed to have acted on behalf of the offeror or offeree through the law of agency. *See, Network Solutions, Inc. v. Hoblad, B.V.*, 2003 WL 22989688 (4th Cir.(Va.)) (not selected for publication in the federal reporter) (4th Cir.(Va.), Dec 19, 2003) (NO. 03 1226) (online registration agreement’s jurisdiction clause held enforceable even though accepted through intermediaries who were deemed agents of the defendants.)

C. Preemption

Online contracting often deals with services or goods that are based on technology. Copyright or patent law in turn protects the offeror’s interest in this technology. One of the developments in online contracting case law deals with whether the Copyright Act preempts contract claims. *See Bowers v. Baystate Technologies, Inc.*, 320 F.3d 1317 (Fed.Cir. 2003) (shrink-wrap agreement expressly prohibited “reverse engineering” and the Court held that under First Circuit law, the Copyright Act does not preempt or narrow the scope of Bowers’ contract claim.)

The preemption issue is an expansion of the jurisdiction issue as the infringement claims under the Copyright Act will be in federal jurisdiction, but the contract claims will be in a state court’s jurisdiction. The Second Circuit took the time to summarize the considerations and the law development leading up to the court’s ultimate conclusion if a claim arises under the Copyright Act or is simply a breach of contract claim in *Bassett v. Mashantucket Pequot Tribe*, 204 F.3d 343 (2d Cir. 2000).⁵ A court must look first to whether there is a remedy expressly granted by the Act and then must apply the “essence” test. *Id.* at 351. The “essence” test requires the court to determine if: (1) the infringement claim is incidental; (2) the claim alleges a breach of a condition to, or a covenant of, the contract licensing or assigning the copyright; and (3) the breach is so material that it has created a right of rescission in the grantor. If the claim is not incidental then the court goes on to the second prong of the test and if the breach is a condition it is automatically under the Copyright Act, but if it is a breach of a covenant then the court must continue its consideration under the third part of the test. If the right or rescission is created, then the claim arises under the Copyright Act. *Id.*

⁵ *See* Edwin E. Richards, *Drafting Licenses to Guide Whether Potential Disputes Lie in Contract or Infringement*, 7 Computer Law Review and Technology Journal 1 (Fall 2002).

The *Bassett* court, however, found that the “essence” test has the perverse possibility of bringing into federal court only those cases with *strong* defenses. *Bassett*, 204 F.3d at 353 n.9. The Second Circuit, therefore, chose to revert to the original test created by Judge Friendly in *T.B. Harms Co. v. Eliscu*, 339 F.2d 823, 828 (2d Cir. 1964) which considered whether the remedies were expressly granted by the Copyright Act or where the distinctive policy of the Act required that federal principles control the disposition of the claim.

D. Arbitration

In contesting the applicability of an online contract’s arbitration provision, the initial assessment for the court is still one of contract formation. It is critical that the basic elements of contracting have been met and in particular that acceptance can be shown. *West Waters v. Earthlink, Inc., and OneMain.com, Inc.*, 2003 WL 22461542 (1st Cir. (Mass.) Oct. 31, 2003) (No. 02-1385) (an arbitration provision in a service agreement placed on the web site of both the ISP with whom the plaintiff has contracted and OneMain’s own website not sufficient to show plaintiff had in fact agreed to arbitrate because the defendants failed to produce evidence showing plaintiff had seen the links, or was on notice of the arbitration provision.) The *West Waters* court asked: “[Was plaintiff] only able to access the internet through these websites? How prominently were the links displayed? How were they labeled or explained? None of these potentially relevant issues is answered by the record. And absent a showing that it is reasonable to assume that plaintiff would have seen the links, we are at a loss to see how he could be found to have agreed to arbitrate any disputes with defendants.” *Id.* at *2. See also *SmartText Corp. v. Interland, Inc. and KFKI Systems, Inc.*, __ F.Supp.2d __, 2003 WL 22996743, *2 (D. Kan. Dec. 18, 2003) (No. 03-2393-DWL) (“In other words, Interland cannot turn SmartText’s silence into acceptance by simply sending an e-mail that says, in essence, “If we don’t hear from you within five days, you are deemed to have accepted our services and the terms thereof.”) (*citation omitted.*)

Some states have allowed consumers to challenge arbitration provisions on the contract defense of unconscionability. California and the Ninth Circuit have accepted the unconscionability defense the most often in the last few years in the interest of protecting consumers from certain arbitration provisions which the courts deem to be unilateral, extreme and facially unfair. See *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); and *Circuit City Stores, Inc. v. Mantor*, 335 F.3d 1101 (9th Cir. 2003). While there are no cases specifically involving online contracts and consumers, it is probable that the analysis would be the same. In particular the Ninth Circuit in its latest *Circuit City* case held that an arbitration provision may be substantively unconscionable under California law when it: limits available remedies; reduces the statute of limitations; prohibits the use of class actions; forces the parties to share costs; and gives the company (offeror) the unilateral power to modify or terminate the arbitration agreement. *Id.* at 1107.

II. LEGISLATION DEVELOPMENTS

A. Spam

On December 16, 2003, President Bush signed the “Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003” (“CAN SPAM Act”). The CAN SPAM Act does not go to the extreme of the California anti-spam statute it preempts, but it does provide “for criminal penalties against those who knowingly and materially falsify e-mail header information, as well as those who register five or more e-mail addresses with false information if multiple e-mails are sent from any combination of accounts.” Michael Warnecke and Stratton Shartel, *Year in Review*, 9 Electronic Commerce & Law Report 2, Jan. 14, 2004, at 38. Commercial e-mails will be allowed, but must include a valid return address that is clearly displayed with a recipient’s right to opt out of the e-mails by replying their request to be removed from the sender’s list of e-mail recipients.

Over the course of the next six months, the Federal Trade Commission will establish a “do not e-mail” registry. The FTC will be required to identify issues with such a registry and clarification of how the registry would be applied to children with e-mail accounts. Congress specifically added a preemption clause to ensure that states did not enact laws which prohibit marketing e-mail altogether. The focus of the CAN-SPAM Act is to stop false e-mail senders and deceptive practices now used by spammers to make their spam look like a legitimate e-mail from a business, agency or individual.

B. Content Regulation

The Communications Decency Act of 1996 has a “safe harbor” provision that immunizes ISP providers from liability for content provided by a third party. 47 U.S.C. § 230(c)(1). There were several cases in 2003 dealing with what action an ISP must take before losing its immunity under this section. The Third Circuit in *Green v. America Online*, 318 F.3d 465, 471 (3d Cir. 2003) held that the “signal” which was a disabling program was information in the definition of § 230(c)(1): “No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.” Another America Online case ruled further that AOL was immune from claims that it failed to stop offensive speech because of the § 230 broad grant of immunity to ISP’s for third party content. *Noah v. AOL Time Warner Inc.*, 261 F.Supp.2d 532 (E.D. Va. 2003).

Two additional Ninth Circuit cases expanded this immunity interpretation. *Batzel v. Smith*, 333 F.3d 1018 (9th Cir. 2003) and *Carafano v. Metrosplash.com Inc.*, 339 F.3d 1119 (9th Cir. 2003). In the *Batzel* case, the Ninth Circuit held that the operator of a listserv or website was also immune from liability under Section 230. The *Carafano* case took this level of immunity one step further by holding that the website owner that initiated the interactive communication was still not liable on the basis of Section 230 immunity. The Ninth Circuit held that the online dating company was not the creator or developer of the information posted in response to its questionnaires. *Id.* at 1124.

C. Privacy

The Federal Trade Commission issued the “Safeguards Rule” on May 23, 2003 as part of its enforcement authority under the Gramm-Leach-Bliley Financial Modernization Act of 1999. The FTC drafted the rule to mandate that financial institutions implement a plan which includes internal controls to ensure the security and confidentiality of the customer’s information. Companies, however, are given significant leeway in how they develop and administer the plan, as long as it reflects the size, complexity and nature of their business.

The FTC has previously brought claims against Eli Lilly and Guess? Inc. for disclosure of personal information collected without the consumer’s permission. These claims were settled by requiring new information security programs, which will be certified by an independent professional every other year. *See, generally*, the Federal Trade Commission’s website on its enforcement actions including Guess? Inc. and Eli Lilly at http://www.ftc.gov/privacy/privacyinitiatives/promises_enf.html.

III. CONCLUSION

The legal developments in the United States affecting online contracts continue to be predominated by case law. Transaction attorneys need to work on drafting well-written contracts that address some of the key issues raised in the 2003 highlights. The drafter of the online contract has the ability to control: how the offer is accepted; where any disputes will be litigated or arbitrated; and whether a breach results in contract or copyright law. The acceptance element of the contract process should be clear and unmistakable. The jurisdiction and venue should be contractually set to avoid having a court decide if personal jurisdiction can be found on the “sliding scale” test. If an arbitration clause is to be incorporated, at a minimum it should not share costs and it should not completely eliminate all reasonable remedies. An online contract granting certain rights under copyright law should grant those rights in a provision that expressly addresses the *Harms* and “essence” test concerns.