

Intellectual Property in Internet Transactions

by Glenn A. Gundersen

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The advent of the Internet has brought a great deal of discussion among intellectual property lawyers on a host of high-profile issues, including domain names, linking, and jurisdiction. Much less has been said and written about the impact of the Internet on transactions involving intellectual property.

As Internet domain names and web sites have become important commercial assets, intellectual property lawyers who represent the buyers and sellers of businesses must reorient how they evaluate and negotiate the sale of these assets. Here are some of the ways that the massive commercial impact of the Internet and e-commerce have changed how lawyers handle the intellectual property aspects of mergers and acquisitions.

- Defining intellectual property assets: The Internet domain name is a new kind of property right, combining elements of trademark, property right, and vanity phone number. As such, it will not appear in formbook asset purchase agreements as part of the list of intellectual property assets which are typically transferred in M&A transactions. Most asset purchase agreements *would* call for the transfer of the seller's trademarks to the buyer, but that does not necessarily cover domain names, for two reasons. First, the decision in *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036; 50 U.S.P.Q. 2d 1545 (9th Cir. 1999) confirmed that registration of a domain name, in and of itself, does not create trademark rights in that name, and as a result one cannot assume that the terms "trademark" and "domain name" are interchangeable or synonymous. Many domain names do consist of a trademark followed by ".COM", ".NET", or the like, and if a buyer neglects to list domain names among the assets to be transferred, an agreement which calls for the sale of trademarks could reasonably be interpreted to also contemplate the sale of the corresponding domain names. However, many of the most valuable domain names today consist of generic terms followed by .COM (DRUGSTORE.COM and PETS.COM, for example). These arguably don't fall within the definition of trademarks (especially if they do not lead to an active web site). Thus, a buyer will want to make certain that "domain names" are listed among the assets to be transferred in the sale of a business. Asset purchase agreements typically also provide for a schedule of intellectual property assets, and the buyer will want the seller to include on that schedule a comprehensive list of all Internet domain names held or used by a company (if the entire company is being purchased) or all Internet domain names used or held for use by a business (if only one of the company's businesses is being acquired).

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- Buyer's domain name due diligence: In most M&A transactions, the buyer's intellectual property counsel conducts a due diligence review of the seller's patents, trademark registrations and applications, and copyright registrations to verify that title to those assets is indeed in seller's name. Counsel should now add verification of domain name ownership to the due diligence checklist. It is not unusual to find that a company's domain names are held in the name of an employee or web site developer, and the buyer will want to make sure that any such title problems are identified and remedied prior to closing. A buyer should also consider conducting a trademark search to determine if any third parties own trademark registrations which are identical to the key domain names used by the business being acquired. This will alert the buyer to any potential challenges by trademark owners which could arise post-closing and shut down e-commerce web sites or disrupt the flow of e-mail to the business. Finally, in order to spot any potential for online confusion, buyer's counsel will want to verify whether third parties have registered domain names which are identical or confusingly similar to the key marks or domain names of the business being acquired.

- Website title due diligence: Most businesses outsource the creation and development of their Internet web sites to free-lance web site development firms. The general rule is that a free-lancer retains copyright in its work unless it has executed a written assignment transferring that copyright to the client. In the absence of such a transfer, the client uses its web site graphics and software under an express or implied license from the web site developer rather than owning it outright. Thus, as a due diligence task, buyer's counsel will want to determine who participated in the development and creation of important web site content and software. If agreements exist with outside developers and programmers, buyer's counsel will want to review those agreements to determine what they say about ownership and maintenance of the site. Since licenses to intellectual property are not necessarily automatically transferable, the buyer may need to get the developer's or programmer's consent to step into the seller's shoes as licensee. If the developer retains ownership of copyright in aspects of the site, the developer's permission may be required before the buyer can make modifications to the design of the site. The buyer will want to know what commitments the seller has made for maintenance and updates of the web site, whether those commitments are transferable under the same terms and pricing, whether it is advantageous for the buyer to assume those commitments, and whether the buyer has the option of seeking other vendors or is wedded to the original developer.

- Due diligence as to other agreements: Commercial web sites are increasingly intertwined with third party web sites. Buyer's counsel will need to review and understand the implications of linking, co-branding, portal, and other revenue-sharing arrangements relating to the web sites being acquired.

- Representations and warranties and allocation of liabilities: While most Internet web sites began as static, electronic versions of a company's hard copy brochure, today's sites contain sophisticated features, graphics, and audio-visual content. As the content has become increasingly complex, the amount of intellectual property used in creating and operating a web site has increased dramatically, and the potential for infringement disputes has grown. For example:
 - The high-tech features of state-of-the-art sites require sophisticated software, which may be protected by both copyrights and patents. If the software was not developed in-house, the buyer will require licenses sufficient to permit current and intended uses.
 - Certain aspects of the way a web site business operates may be sufficiently innovative to merit patent protection, and the seller's web site may inadvertently infringe an existing patent, or may later be discovered to infringe an invention which, at the time of the sale, appears only in a pending, non-public patent application.
 - Music, photography, text, graphics and other creative web site content are protected by copyright, and some companies take inadequate measures to acquire the third party permissions necessary to incorporate such material into the web site.
 - Web sites which incorporate chat room or bulletin board features may create opportunities for users to post infringing or defamatory content.

While many of these potential challenges will be covered under the traditional representations that a seller makes about whether its business is infringing the intellectual property rights of others, such language does not cover all the potential claims. Many domain name disputes are framed as trademark dilution claims or administrative proceedings rather than trademark infringement claims, which means that disclosures or representations which refer only to "infringement" may be incomplete. Real-time use of "hot news" information compiled by others may even draw a claim of misappropriation. Finally, the global nature of the Internet creates new hazards. Offering goods for sale in all 50 states, and beyond the U.S., creates exposure under state and foreign consumer protection, tax, and obscenity laws. Buyer and seller will need to negotiate responsibility for those past liabilities.

- Transferring domain names: A bill of sale is insufficient to fully effect the transfer of a domain name, since it does not effect a change of title in the domain name registrar's records. Counsel for buyer needs first to determine which domain name registration organization (Network Solutions, Register.com, or another) registered the name, and then to determine how to

comply with that organization's requirements for transferring the domain name. Such transfers are an aberration from the M&A lawyer's expectation that all transfers can be effected by the execution of hard copy documents in a conference room on closing day, in that domain transfers may also require the electronic filing of domain name transfer instructions. In addition, from a practical standpoint, if the buyer is not acquiring the seller's servers or other hardware and software used to operate the website, the buyer will need to make plans prior to closing for a smooth technical transition on closing day to its own facilities or for having the seller provide transition services until buyer's facilities are operational.

- Financing the acquired assets: Buyers often finance the acquisition of new businesses by granting lenders a security interest in the acquired assets, and the typical financing modus operandi needs to be adjusted to reflect the importance of Internet assets. A wise lender will attempt to secure its financing by taking a security interest in as many key assets of the borrower as possible-- including domain name registrations. Although there thus far appears to be no case law on the subject, domain name registrations would likely be considered to be "general intangibles" and a security interest in those registrations would be perfected by filing financing statements in the appropriate state and/or local UCC offices. Cf.. *In re Matter of Remes Glass, Inc.*, 136 B.R. 132, 134 (Bankr. W.D. Mich. 1992) (holding that telephone numbers can be subject of valid security interest); *In re Mid-West Motors, Inc.*, 82 B.R. 439, 440 (Bankr. N.D. Tex. 1988) (accord). However, if the borrower has registered or applied to register a domain name as a federal trademark, it is advisable (although not essential) to also record the security interest in the trademark in both the U.S. Patent and Trademark Office and the appropriate UCC offices. The secured party should make sure that the borrower pays the necessary fees to maintain the domain name registration and otherwise satisfies its obligations under its agreement with the relevant domain name registration organization. The secured party should also make sure that it will be able to obtain control over the domain name registration in the event of default (including, if necessary, obtaining powers of attorney or other documentation).

While e-commerce has changed the way that intellectual property lawyers must approach traditional business acquisitions, the Internet has also spawned entirely new types of agreements related to web sites--and most (if not all) of these agreements include provisions dealing with traditional intellectual property rights. In particular, trademarks are frequently the subject of licenses or cross-licenses in e-commerce contracts. The following are some major categories of web-related agreements, along with important trademark provisions that may differ from those in standard licensing arrangements:

- Web development agreements: As noted above, most businesses turn to an outside “developer” to design their company’s web site. The developer may provide a variety of services, including conversion of files to HTML and other web-friendly formats; designing the look and feel of web pages; coding pages and applications; and tracking site usage by the public. Development agreements raise a variety of trademark issues:

- Companies should generally register domain names directly with an authorized registrar. If the developer assists with the registration of a domain name, the development agreement should specify that the name is the sole property of the client, and that the client will be listed as the administrative and billing contact with the domain name registrar. Although trademark owners may have certain rights in a domain name prior to registration of the name, wresting a domain name away from an unauthorized user involves time, money, and legal uncertainty.

- In addition to specifying ownership of materials created during the project, development agreements should explicitly protect pre-existing intellectual property, including the client’s trademarks.

- Development agreements should not only prohibit developers from incorporating unlicensed third-party trademarks on the client’s web site, but should also restrict the “framing” of third-party material from elsewhere on the web. Simple hyperlinks to other sites generally do not create trademark liability, but developers should not link to other sites in any way that might confuse users about the source or sponsorship of linked material. In certain situations, a client may wish to enter into a linking agreement with the owner of the linked site.

- Site designers often include “meta tags” in a web page’s HTML code. Meta tags are invisible to users but are detected by search engines; designers thus employ meta tags, as well as other forms of hidden text, to direct traffic to their sites. Depending on the circumstances, trademark liability may or may not arise from the use of an unlicensed trademark as a meta tag. *Compare Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036 (9th Cir. 1999) (defendant’s use of competitor’s mark in meta tags created initial interest confusion in violation of trademark law), with *Playboy Enterprises, Inc. v. Welles*, 7 F.Supp.2d 1098 (S.D. Cal.), *aff’d without opinion*, 162 F.2d 1169 (9th Cir. 1998) (defendant’s use of plaintiff’s trademark constituted fair use). Consequently, development agreements should specifically address which uses of third-party trademarks, if any, are to be permitted.

- Co-branding agreements: In a typical co-branding arrangement, one company (the “provider”) creates a version of its own web site that features the marks of an affiliated company (the “brander”). The brander’s web site

will offer a link to the co-branded site and may also display the provider's marks. (If the provider operates software, such as an e-mail program, on behalf of the brander, the arrangement is called "outsourcing.") Not surprisingly, co-branding agreements involve a variety of trademark issues:

- Both parties will want to control how their marks appear on the other company's site (e.g., size, placement on the page, notice of registration, identification of owner). The co-branding agreement should outline an approval procedure whereby samples of proposed uses are submitted to the trademark owner.
 - By definition, the co-branded site will display the brander's mark, but the provider may wish to specify that this mark will not operate as a link to the brander's web site. Such a clause will help the provider (e.g., a reseller) to capture sales that would otherwise be lost to the brander (e.g., a manufacturer).
 - One or both parties may desire an exclusivity provision. Such a provision will list specific competitors, or categories of companies, with which one party may not enter into certain agreements. Providers seeking increased traffic from the brander's site should push for exclusivity, so that the brander does not direct users to multiple providers. Parties can maintain flexibility by limiting exclusivity to a short initial term.
 - The co-branding agreement should specify who must register and maintain the co-branded site's domain name, and who will retain ownership of the name after the expiration or termination of the agreement.
- Cross-promotion and content sharing agreements: These agreements differ from co-branding arrangements in that no new "branded" web site is created. Rather, the parties use their existing sites to promote, and provide content for, each other's sites. As in co-branding agreements, trademark owners should seek to exercise control over their marks by narrowly defining permitted uses and/or establishing an approval procedure.
- Linking agreements: As noted above, linking to another party's web site may raise trademark infringement concerns in limited contexts (e.g., when the linked material is "framed"). On the other hand, linked sites often welcome -- and will sometimes pay for -- the additional traffic that a link offers. For these reasons, site owners should consider either obtaining consents from linked sites or entering into more elaborate agreements. Since a link will often include the linked party's trademark, linking agreements should address issues such as link placement and appearance. The linked

party should also seek to ensure that the respective owners of the web sites are clearly identifiable to users.