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Report From Counsel

Insights and Developments in the Law Summer 2007

Doing Business on the Web—Clickwrap Agreements

Every day, more and more business transactions are conducted over the Internet. Many of these transactions begin with a "clickwrap agreement." Clickwrap agreements are variations on "shrinkwrap" agreements, those printed terms and conditions usually found in the packaging for software. Clickwraps basically work the same way, but the user agrees to the terms by clicking a button on his computer, instead of by opening the package and using the product. While clickwrap agreements are still widely associated with software licensing, their use has spread to a wide range of business settings, such as advertising services, telecommunications, and banking, to name only a few.

Companies should seek and use the advice of legal counsel as they create clickwraps tailored to particular businesses.

Given that clickwraps have become ubiquitous, it is prudent for businesses to consider their advantages and to be informed as to the desirable characteristics that any clickwrap agreement should have. As compared with their paper predecessors, clickwraps are easier and quicker for a customer to accept, and more difficult for the customer to attempt to change. They provide a measure of control that is to the business's advantage. Depending on the size of the business and its market, clickwraps can be the means by which countless relationships are formed and deals are struck, so it is vital for any business using them to get all of the details correct. To ensure enforceability and to head off later legal problems to the greatest extent possible, companies should seek and use the advice of legal counsel as they create clickwraps tailored to particular businesses.

Once a business decides to use a clickwrap agreement, there are certain traits that should be considered:

- Put the steps in the right order. Before a customer is expected to pay for the product or service, or is allowed to receive it, he should be

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Real Estate Law Update

Rentals Allowed Under Restrictive Covenant

After a couple bought property in a subdivision, they were surprised to learn that several homes near theirs were going to be offered as vacation rental property. Strangers on vacation were not the neighbors the couple had in mind. All of the properties in the subdivision were subject to a set of restrictive covenants, one of which required that lots be used for "single-family residential purposes only." The couple sued to get a court to declare that renting a home, even to one family, violated that restriction, but the couple came out on the losing end of the litigation.

In the plaintiffs' view, to derive rentals from a home was to convert the property from single-family residential use to a prohibited commercial or business use. The court disagreed. Citing statistics showing that in most states over 30% of homes are rented rather than owned by the families living in them, the court reasoned that an owner's receipt of rental income does not detract from or change the "residential" use of the property.

The plaintiffs' position was undercut by a separate covenant that permitted delegation of certain owner rights to "tenants," thus obviously contemplating the rental of property. The plaintiffs argued that only long-term rentals were allowed, not short-term vacation rentals, but they could point to no language supporting such a distinction.

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Establishing Patent Priority for Interfering Patent Applications

Under the United States patent system, patents are awarded to inventors who are the first to invent, as opposed to the first to file a patent application. Unless another inventor can show that he conceived of an invention first, and was reasonably diligent in later reducing the invention to practice, the inventor who first reduces the invention to practice is entitled to the patent. "Reduction to practice" can be either constructive, such as by filing a patent application, or actual, such as by constructing a working model or prototype of a product, carrying out the steps of the invented method, or producing the composition of an invented material.

A company should adopt and rigorously follow procedural guidelines for recordkeeping in connection with any of its work that could lead to a patent.

In litigation over competing, sometimes called "interfering," patent applications for the same invention, evidence of actual reduction to practice is pivotal in establishing the priority of an invention. Such evidence is the "meat on the bones" of a legal case for establishing priority in an interference proceeding. The winning party will have to show that it constructed the claimed embodiment or performed the claimed process, that the embodiment or process functioned for the intended purpose, and that there is sufficient evidence to corroborate the inventor's testimony as to the first two requirements.

The importance of unassailable evidence of reducing an invention to practice is illustrated by a case in which two companies were competing for a patent for making an active ingredient in an allergy medication. Neither party relied on a date of conception, so the case turned on who first reduced the invention to practice. One company had the earlier filing date on its application, but the second company claimed that it had earlier reduced the invention to practice.

Given the subject matter of the invention, the second company's evidence was in the form of laboratory data and notebooks kept by individuals closely associated with the inventive process. Unfortunately for that company, flaws in this evidence greatly diminished its weight and led the court to rule in favor of the first company. Essentially, the evidence lacked sufficient corroboration, such as by signing notebooks, using witnesses to vouch for their authenticity, or having individuals testify as to the genuineness of the notebooks' contents. Such shortcomings likely would have been enough by themselves to tip the balance, but evidence of fraudulent backdating of notebook entries was another fatal blow to the second company's case.

Make Sure to Carefully Document Evidence

There is no single, exclusive method for marshaling and authenticating evidence for use in a patent priority battle, but the case of the allergy medication ingredient suggests that a meticulous approach is prudent. Examples of practices that should be in

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Tax Consequences of Selling Collectibles

Collectibles, such as gold and silver coins, works of art, antiques, and stamps, have seen significant appreciation in value lately. As the buying and selling of collectibles pick up, it is important to be familiar with the tax consequences of such transactions.

If collectibles are sold at a profit, the price increase is treated as a capital gain for income tax purposes. For a holding period of more than one year, the gains are long-term. The downside for sellers is that long-term gains on collectibles are taxed at 28%, not the 5% or 15% rate likely to be used for gains from the sale of other forms of property. To establish the basis, which is the cost of an item for tax purposes, owners of collectibles should keep records of the price paid for items, as well as records of any expenses related to the items, such as insurance or storage costs. The expenses may be added to the basis, thus decreasing the taxable capital gain when the property is sold.

Someone who inherits valuable collectibles will receive a "step-up" in basis to market value at the time of inheritance, rather than using a basis determined by the earlier cost of acquiring the property. The new, higher basis means a reduced tax when the property is eventually sold. Inherited collectibles should be appraised right away, so as to establish the value to be used for the stepped-up basis.

Estate Planning 101: What Is a Trust?

A trust is a legal instrument that transfers title to designated property from the owner, called the donor or grantor, to a trustee, who holds the property for the beneficiaries of the trust. The grantor can also serve as the trustee, thereby enhancing control over the trust during the life of the grantor. In such a case, a successor trustee is usually named in case the grantor dies or is incapacitated. Depending on the size or complexity of the trust, the trustee, or cotrustee, might be an institution, so as to bring more expertise to the position.

Testamentary Trust

A testamentary trust, created in a will, takes effect when the grantor dies. It names the beneficiaries and gives directions for payment of the income from the trust and for disposition of the assets. The testamentary trust has the advantage of increasing the odds that an inheritance is used prudently. The trustee can manage the assets of the trust until such time as the beneficiaries are prepared to do so, as opposed to an immediate transfer of assets to the beneficiaries.

Living Trust

The second category of trusts is the living, or inter vivos, trust, which is created during the grantor's lifetime. An important decision for a living trust is whether the trust will be revocable by the grantor or irrevocable. In either case, the assets are retitled in the name of the trust. As the name suggests, a revocable trust may be dissolved entirely by the grantor. But short of that, the grantor may also change beneficiaries, replace the trustee, or change the composition of the assets in the trust. Revocable trusts do not remove assets from the grantor's estate. The grantor pays taxes on the trust income, and if any assets remain in the trust at the death of the grantor, they are part of his estate and at least potentially taxable as such. A revocable trust has few tax advantages.

As the name suggests, a revocable trust may be dissolved entirely by the grantor.

An irrevocable trust permanently takes assets out of the grantor's estate and puts them into the trust. While tax savings can be realized with an irrevocable trust, this type of trust is not to be entered into lightly, as it will take action by a court to alter it later. For tax purposes, the trust becomes a separate entity. Assets in the trust generally are not subject to estate taxes on the death of the grantor, but the transfer of assets into the trust may be subject to gift taxes.

When the grantor for a living trust dies, the trust assets pass directly to the beneficiaries. This is a distinct advantage over having to go through probate, the often costly and time-consuming process of administering a will. A living trust also maintains the privacy of the estate, because bypassing probate also means that no public record is created, as occurs with probated wills.

Effective use of trusts in estate planning requires not only awareness of these trust basics, but familiarity with specialized trusts that might be a good fit for particular cases, such as those involving life insurance policies and charities. To decide on and implement the best option, use the services of qualified professionals.

Patent Priority

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place include bound notebooks for inventors, with each page signed and dated in permanent ink not only by the creator of the notebook, but also by a disinterested but informed noninventor; placement of entries in chronological order; and initialing and dating of any corrections. Inventors should record as much detail as possible about their activities and conclusions relating to the invention, and there should be a full explanation for any supplementary materials. Finally, all of this attention to detail and following of procedures could be for naught unless the information is kept in a secure place to which there is authorized access only.

Just as scientific methods must be followed in the very work that leads to a patented invention, a company should adopt and rigorously follow procedural guidelines for recordkeeping in connection with any of its work that could lead to a patent. Otherwise, there is a great risk of wasted effort and the loss of what could be very valuable intellectual property.

Clickwrap Agreements

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given the chance to review the entire clickwrap agreement and the option to accept or reject all of its terms and conditions.

- Identify the user. If the party who comes to a company's clickwrap represents another company, it is especially important to get identifying information that will show that the user is authorized to bind his company to the agreement. To this end, the clickwrap should have places for the user's name, the company's name, the user's title, and both e-mail and physical addresses. Of course, aside from its value for such verification purposes, the identifying information can be useful in other ways.
- Do not make the user hunt. The clickwrap should be readily apparent to a user, and the "install" or "download" button should appear only after the clickwrap is set out in its entirety. In the same vein, a checkbox indicating that the user has agreed to the terms of the clickwrap makes good sense. The idea is to prevent anyone from claiming in a later dispute that there were parts of the agreement that he could not have easily seen, and to which he did not give his assent. As for any terms that are weighted in favor of the business, making them hard to find is an especially bad idea. On the contrary, these terms should stand out, maybe even with their own "I agree" checkbox.
- Drop the legalese. As is true for any contract, a clickwrap should use clear, plain English. It is well settled in law that a court will construe ambiguous terms against whoever wrote them, that is, the business whose clickwrap is being deciphered.
- Make the clickwrap control. If there are any other dealings with the user, whether oral or written, that conceivably could be said to constitute a separate agreement, they all should explicitly defer to the clickwrap agreement. Likewise, the clickwrap itself should have language indicating that its terms override any conflicting terms in other agreements relating to the transaction.
- Keep the final word for your business. What if a user navigates successfully and accepts the clickwrap agreement, but your business determines for some reason that it wants no business relationship with that user? The business should provide itself with an escape hatch, with language in the agreement to the effect that the business must confirm the agreement before it becomes enforceable, or that the business can cancel the agreement at will.

Clickwrap agreements have gained acceptance as valid, enforceable contracts, albeit in an unconventional format. This point is illustrated by a recent federal court decision. In a breach-of-contract dispute between two software companies concerning the use of licensed software, the court hardly paused at the question of whether a clickwrap agreement constituted a valid contract. In answering "yes," the court also relied on an extensive list of prior court decisions that had reached the same conclusion. The clickwrap agreement has become a permanent part of the legal landscape for businesses and individuals alike.

Real Estate Law

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Seller's Duty to Disclose

Before building a home on property it owned, a developer obtained a study of the soil conditions in the area that included the lot for the home. The study was prompted by the fact that a church that formerly owned adjoining land had abandoned plans to build a church structure on that land because of its own study indicating that there was too much collapsible soil to support the building. After receiving the soil study of the neighboring land, the developer dug out some soil on the lot for the home, reducing its grade by about six feet, and built the new house.

That there were any concerns over soil suitability came as news to the buyers of the new home when, not long after the purchase, cracks appeared in the foundation, doors would not open or close, and, as the court later put it, "[e]vidence of excessive settling abounded."

The developer had not disclosed the contents of the soil study to the buyers. A state supreme court ruled that the buyers' lawsuit for fraud should go to a jury. The court reasoned that a developer/builder may owe his buyer a duty to disclose information known to him concerning real property, including property not being conveyed to the buyer, when that information is material to the condition of the property being purchased. To be material, the information must be "important." Importance, in turn, is measured by the degree to which the information could be expected to influence the judgment of a person buying property.

In the case before it, the court found that a jury could well conclude that the buyers would have wanted to know about collapsible soil on adjacent land before they bought their home. In the court's view, a property boundary should not be considered a perimeter outside of which, as a matter of law, nothing is material to a prospective buyer.