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Legal aspects of electronic commerce

Electronic contracting: background information

Note by the Secretariat

Contents

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I. Introduction

1. The present note summarizes the research that has been conducted by the Secretariat on some of the main issues that have been discussed by Working Group IV (Electronic Commerce) in connection with its deliberations on a preliminary draft convention on electronic contracting.[1] Its purpose is to assist the Working Group in its deliberations at its forty-second session (Vienna, 17-21 October 2003).

2. The issues dealt with in this note relate essentially to the location of the parties. Additional background notes dealing with other issues, such as the qualification of the parties' intent, time of dispatch and receipt of data messages, authentication and attribution of data messages, use of automated information systems and the availability of contract terms and other information will be issued as separate documents.

II. Issues related to location of the parties

3. One of the central concerns of the Working Group since its initial discussion of issues raised by electronic contracting has been the need to enhance legal certainty and predictability. This might be achieved by uniform rules that facilitated a determination, among other factors, of the international or domestic character of a contract and the place of its formation. The Working Group felt that it would be generally desirable to formulate uniform international provisions offering elements that allowed the parties to ascertain beforehand the location of their counterparts (A/CN.9/484, para.103).

4. The underlying concern in the Working Group's consideration of this issue has been that the increased use of electronic communications makes it all the more important for traders to ascertain reasonably quickly some key contractual issues such as whether a valid and enforceable contract has been concluded and which law governs it.

5. Most international commercial law conventions have their field of application circumscribed to "international" transactions. The solutions adopted at both the national and international levels for defining an "international" contract range from general criteria, such as the contract having "significant connections with more than one State" or relating "to international commerce", to more specific factors, such as the fact that the parties have their "places of business" or habitual residence in different countries.[2] If a party has more than one place of business, those instruments refer to the place that has the closest relationship to the contract and its performance.[3]

6. When the parties to a contract concluded electronically clearly indicate the location of their relevant place of business, that indication is to be taken into account as an important criterion, if not the most important one, in determining the "international" character of a contract.[4] However, this rule is of little help if no such indication has been made.

7. Difficulties might also arise under domestic rules on conflicts of law, which often use notions commonly found in international conventions (for example, "place

of business" or a place having the "closest connection with a contract or its performance"). Additional problems may also result from rules of private international law that refer to the place of conclusion of the contract as a connecting factor, since the location of the parties may not be evident from the electronic communications they exchange.

8. In view of the above, the Working Group has considered whether there exist circumstances from which the location of the relevant place of business can be inferred and which might be used to establish a legal presumption of a party's location.

A. Location of information systems

9. Even if transmission protocols of electronic communications do not usually indicate where the parties are located, they often include a number of other types of apparently objective information, such as Internet Protocol (IP) addresses,[5] domain names[6] or information pertaining to intermediary information systems. So the question arises as to what value, if any, could be attached to such information for the purpose of determining the physical location of the parties.

10. The preparatory studies carried out by the Secretariat in connection with the first version of the preliminary draft convention suggested that the location of the equipment and of its supporting technology might not be adequate factors for determining the location of the parties, since they did not provide sufficient indication as to the ultimate parties to the contract, might change over time and were often not known or not apparent to the parties during their communications (A/CN.9/WG.IV/WP.95, para. 42). It was also pointed out that the management and operation of an information system might be entirely outsourced or run by a third party. For example, a contract made on behalf of the seller might be automatically concluded with the buyer by the computer of the Internet service provider (ISP) that hosts the seller's web site. Reliance on the location of equipment might thus lead to the undesirable result of linking a contract to a geographical location that, although related to the path followed by the electronic messages exchanged by the parties, bears perhaps little or no relationship to their actual location.[7] Another undesirable result might be that a person's place of business, when negotiating a contract electronically, might end up being different from the same person's place of business when negotiating through other means.[8] The Working Group has generally endorsed this analysis (A/CN.9/509, paras. 50 and 57).

11. Nevertheless, it is conceivable that electronic commerce and the "new economy" may involve activities that are entirely or predominantly carried out through the use of information systems, without a fixed "establishment"[9] or without any connection to a physical location other than, for instance, the registration of its articles of incorporation at a given registry. It has been argued that it might not be reasonable to apply to those so-called "virtual companies" the same criteria traditionally used to determine a person's place of business. In other words: Is it appropriate to give legal significance to the location of the equipment and technology supporting the information system or the places from which such a system may be accessed in order to establish where such a "virtual company" has its place of business?

12. To date, the Working Group does not seem to be inclined to depart from established criteria linked to the notion of "place of business" (A/CN.9/509, paras. 51-54 and 56-59; see also A/CN.9/528, para. 93). However, a full discussion of "virtual places of business" has not yet taken place. In that connection, the Working Group may wish to take note of related work that has been done by other organizations.

13. The issue of location of entities offering goods and services through electronic means has been considered by the Organisation for Economic Cooperation and Development (OECD) in the context of its work on international aspects of taxation. On 22 December 2000, the OECD Committee on Fiscal Affairs adopted changes to the commentary on article 5 of the Model Tax Convention on Income and on Capital ("the OECD Model Tax Convention") to deal with the issue of the application of the definition of permanent establishment, as understood in the context of the Model Tax Convention, in connection with electronic commerce.[10]

14. The OECD Committee on Fiscal Affairs points out that, while a location where automated equipment is operated by an enterprise "may constitute a permanent establishment in the country where it is situated", a distinction needs to be made "between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment". According to that interpretation, an Internet web site, which is a combination of software and electronic data, "does not in itself constitute tangible property and therefore does not have a location that can constitute a 'place of business' as there is no 'facility such as premises or, in certain instances, machinery or equipment' […] as far as the software and data constituting that web site is concerned". On the other hand, the Committee on Fiscal Affairs points out that a "server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a 'fixed place of business' of the enterprise that operates that server".[11]

15. The distinction between a web site and the server on which the web site is stored and used is justified on the following grounds:

> "[…] the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise […], even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment

of the enterprise if the other requirements of [article 5 of the Model Tax Convention][12] are met."

16. For the purpose of distinguishing between a web site and the server on which it is stored, the OECD Committee on Fiscal Affairs stresses the importance of identifying the place of performance of the core functions of a business entity, as opposed to ancillary activities (e.g. provision of a communications link between suppliers and customers, advertising of goods or services, relaying information through a mirror server for security and efficiency purposes, gathering market data for the enterprise or supplying information). In that connection, the following clarification is provided:

> "42.9 What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an 'e-tailer') that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), […] the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there), these activities cannot be considered to be merely preparatory or auxiliary."

17. The above clarification shows the narrow conditions under which a server may be regarded as a permanent establishment for taxation purposes. While the term "place of business", as generally defined in private law may not necessarily coincide with the notion of "establishment" under domestic and international tax law, the Working Group may nevertheless wish to consider the extent to which the clarification provided by the OECD Committee on Fiscal Affairs offers elements that might be used in connection with article 7 of the preliminary draft convention.

B. Domain names and electronic addresses

18. Another related question is the extent to which the address from which the electronic messages were sent could be taken into account to determine a party's location, so that in the case of addresses linked to domain names connected to specific countries (such as addresses ending with ".at" for Austria, ".nz" for

New Zealand, etc.) the party could be presumed to have its place of business in the corresponding country.

19. In the course of the Working Group's deliberations, it was stated that, in some countries, the assignment of domain names was only made after verification of the accuracy of the information provided by the applicant, including its location in the country to which the relevant domain name related. For those countries, it might be appropriate to rely, at least in part, on domain names for ascertaining a party's location (A/CN.9/509, para. 58). However, in countries where no such verification takes place, an electronic mail (e-mail) address or a domain name could not automatically be regarded as the functional equivalent of the physical location of a party's place of business.[13] Moreover, in certain branches of business it is common for companies to offer goods or services through various regional web sites bearing domain names linked to countries where such companies do not have a "place of business" in the traditional sense of the term. Furthermore, goods being ordered from any such web site might be delivered from warehouses maintained for the purpose of supplying a particular region, which might be physically located in a country other than those linked to the domain names involved.

20. The Working Group may wish to explore further the possible role that domain names and e-mail addresses may play in establishing presumptions of a party's location and how such a presumption should be formulated so as to take into account the various domestic systems and practices for the assignment of domain names. One particular situation that the Working Group may need to bear in mind relates to the use of "generic" top-level domains[14] such as ".com" or ".net". Those types of domain name and e-mail address do not show any link to a particular country, which is possible because the system of assigning domain names for Internet sites has not been conceived in strictly geographical terms.

C. A duty to disclose the place of business?

21. The above discussion has shown that peripheral information related to electronic messages, such as an IP address, domain names or the geographical location of information systems, may have limited value for determining the physical location of the parties.

22. One approach being considered by the Working Group is to require the parties to electronic transactions to clearly indicate the location of their relevant places of business, as currently contemplated in articles 7, paragraph 1, and 11, subparagraph 1 (b), of the preliminary draft convention. However, that proposition has raised a number of questions, such as the extent to which such a duty, which does not exist for international paper-based transactions, might result in a duality of legal regimes (see A/CN.9/509, para. 63). Another concern is what kind of legal consequences might be attached to the lack or inaccuracy of such information and how an international uniform instrument on electronic contracting could deal with that issue without unduly interfering with the underlying contract law (A/CN.9/509, paras. 44-50 and 62-65; A/CN.9/528, paras. 83-91).

23. The Working Group may wish to note that, although no similar disclosure obligation exists in the United Nations Sales Convention, a number of other instruments contain provisions that contemplate an obligation for a party to disclose

its place of business. This is the case, for example of article 15, subparagraph 1 (c), of the United Nations Convention on the Transport of Goods by Sea ("the Hamburg Rules")[15] and—at least implicitly—in article 4, paragraph 1, of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (General Assembly resolution 50/48, annex). While it is true that those provisions relate to the required content of particular documents that have to be issued under those Conventions, there seems to be no prima facie reason for excluding analogous rules in the context of the preliminary draft convention, inasmuch as its article 11 deals with information that has to accompany business transactions.

24. The possible consequences of failure by a party to comply with draft article 11 do not need to be the nullity or non-enforceability of the transaction, a solution that was said to be "undesirable and unreasonably intrusive" (A/CN.9/509, para. 63). Paragraph 3, article 15, of the Hamburg Rules, for example, clearly provides that the absence in the bill of lading of one or more required particulars "does not affect the legal character of the document as a bill of lading provided that it nevertheless meets the requirements". Other types of consequence may still be provided for, with a view to giving a meaningful purpose to article 11 of the preliminary draft convention.

25. One possible type of consequence might be linked to the field of application of the draft convention. For example, a party that fails to disclose its place of business might be presumed to have agreed to subject the contract to the regime of the draft convention if the other party is located in a contracting State and the applicable law is the law of a contracting State. Of course, such a solution would only be effective if the convention could be made applicable by the agreement of the parties, even if they were not both located in contracting States, a possibility that the Working Group has not yet fully considered (A/CN.9/528, paras. 43 and 44).

26. Court decisions may offer alternative legal consequences that may be attached to a party's deliberate or inadvertent failure to disclose its place of business. In one recent case, a court in the United States upheld the service of process against a foreign company by electronic means on the grounds that the foreign company had structured its business in such a way that it could be contacted only via its e-mail address and had listed no easily discoverable street address.[16] Such a result may not be easily transposed to the context of an international commercial law instrument. Nevertheless, this line of jurisprudence provides an example of a type of legal consequence that the Working Group might wish to consider, namely a presumption of consent to the receipt of messages or legal notices through a particular information system for parties that do not otherwise disclose their places of business.

Notes

[1] The first version of a preliminary draft convention on electronic contracting is contained in document A/CN.9/WG.IV/WP.95. The Working Group considered that text at its thirty-ninth (New York, 11-15 March 2002) and fortieth sessions (Vienna, 14-18 October 2002). The Working Group's deliberations are reflected in its reports on the work of those sessions (A/CN.9/509 and A/CN.9/527, respectively). A second version of the preliminary draft convention is contained in document A/CN.9/WG.IV/WP.100, which was considered by the Working Group at its forty-first session (New York, 5-9 May 2003). The Working Group's

deliberations are reflected in its report on the work of that session (A/CN.9/528), at which the Working Group requested the Secretariat to prepare a revised version of the preliminary draft convention, for consideration at its forty-second session. That text is contained in document A/CN.9/WG.IV/WP.103.

[2] For example, United Nations Convention on Contracts for the International Sale of Goods ("United Nations Sales Convention") (United Nations, *Treaty Series*, vol. 1489, No. 25567, p. 3, also available from www.uncitral.org/english/texts/sales/CISG.htm), article 1, paragraph 1; Convention on the Limitation Period in the International Sale of Goods ("United Nations Limitation Convention") (United Nations, *Treaty Series*, vol. 1511, No. 26119, p. 1), article 2, subparagraph (a); and article 1, subparagraph (a), of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (*Official Records of the General Assembly, Fiftieth Session, Supplement No. 17* and corrigendum (A/50/640 and Corr.1, annex). See also UNIDROIT Convention on International Financial Leasing, article 3, subparagraph 1 (a) (www.unidroit.org/english/conventions/c-leas.htm) and UNIDROIT Convention on International Factoring, article 2, subparagraph 1 (a) (www.unidroit.org/english/conventions/c-fact.htm).

[3] E.g. United Nations Sales Convention, article 10 (a); United Nations Limitation Convention, article 2 (c); United Nations Guarantees and Stand-by Convention, article 4, paragraph 2 (a); UNIDROIT Convention on International Financial Leasing, article 3, paragraph 2; and UNIDROIT Convention on International Factoring, article 2, paragraph 2.

[4] For instance, under the United Nations Sales Convention.

[5] The Internet Protocol (IP) address is a 32-bit number (128 according to IP version 6) that identifies each sender or receiver of information that is sent in packets across the Internet.

[6] A domain name is a name assigned to a numerical IP functioning as part of a uniform resource locator (URL).

[7] The need to retain the same definitions that are used for off-line transactions is also mentioned in Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the internal market (*Official Journal of the European Communities* L 17, 17/07/2000 p. 0001 016), where it is stated that:

> "The place at which a service provider is established should be determined in conformity with the case-law of the Court of Justice according to which the concept of establishment involves the actual pursuit of an economic activity through a fixed establishment for an indefinite period; […] the place of establishment of a company providing services via an Internet website is not the place at which the technology supporting its website is located or the place at which its website is accessible but the place where it pursues its economic activity."

[8] The risks of establishing a dual regime for business, depending on the media being used, has been one of the main concerns expressed by the International Chamber of Commerce in connection with UNCITRAL's current work on electronic contracting (see A/CN.9/WG.IV/WP.96; see also A/CN.9/WG.IV/WP.101).

[9] Thibault Verbiest and Maxime Le Borne, "*Le fonds de commerce virtuel: une réalité juridique?*" (www.droit-technologie.org), 24 May 2002.

[10] Organisation for Economic Cooperation and Development, *Clarification on the application of the permanent establishment definition in e-commerce: changes to the commentary on the Model Tax Convention on Article 5* (available at www.oecd.org/dataoecd/46/32/1923380.pdf, last visited on 3 September 2003).

[11] Ibid., para. 42.2.

[12] Paragraphs 1, 2 and 4 of article 5 ("Permanent establishment") of the Model Tax Convention reads as follows:

> "1. For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
>
> "2. The term 'permanent establishment' includes especially:
>
> "*a*) a place of management;
>
> "*b*) a branch;
>
> "*c*) an office;
>
> "*d*) a factory;
>
> "*e*) a workshop, and

"*f*) mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

"[…]

"4 Notwithstanding the preceding provisions of this Article, the term 'permanent establishment' shall be deemed not to include:

"*a*) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

"*b*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

"*c*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

"*d*) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

"*e*) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

"*f*) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

"[…]."

[13] According to the Internet Corporation for Assigned Names and Numbers (ICANN), the assignment of top-level domain (TLDs) names including a country code (ccTLDs) is "delegated to designated managers, who operate the ccTLDs according to local policies that are adapted to best meet the economic, cultural, linguistic, and legal circumstances of the country or territory involved" (www.icann.org/tlds/). Needless to say, each country develops its own detailed rules for assigning domain names within its jurisdiction. The Swedish domain name registration system, for instance, seems to require proof of a company's claim to the domain name and its link to the country, whereas more "liberal" systems, such as that of Germany, only require the existence of a "contact person" in the country (see Frederik Roos, " 'First come, not served': domain name regulation in Sweden", *International Review of Law Computers and Technology*, vol. 17, No. 1, p. 70).

[14] "Generic" TLDs are registered directly through ICANN-accredited registrars (for further information on the system, see www.iana.org/cctld/cctld.htm).

[15] United Nations, *Treaty Series*, vol. 1695, No. 29215, p. 3.

[16] *Rio Properties, Inc. v. Rio International Interlink*, United States Court of Appeals for the Ninth Circuit, 17 January 2002 (284 F.3d 1007). This case involved various trademark infringement claims by an American company against a foreign Internet business entity. After failed attempts to serve the defendant by conventional means in the United States of America, the claimant brought an emergency motion to effectuate alternative service of process by e-mail, which had been identified as being the defendant's preferred means of communication. The district court granted the motion. The district court entered default judgement against the defendant for failing to comply with the court's discovery orders. The defendant appealed the sufficiency of the service of process, effected via e-mail and regular mail pursuant to Federal Rule of Civil Procedure 4(f)(3). This rule permits service in a place not within any judicial district of the United States "by ... means not prohibited by international agreement as may be directed by the court". The Court of Appeals concluded that not only was service of process by e-mail proper—that is, reasonably calculated to apprise the defendant of the pendency of the action and afford it an opportunity to respond—but, in this particular case, it was the method of service most likely to reach the defendant. The Court noted in that connection that the defendant "structured its business such that it could be contacted only via its e-mail address" and that it "listed no easily discoverable street address". Rather, on its web site and print media, the defendant "designated its e-mail address as its preferred contact information".