UNIT 7 ISSUES EMERGING FROM ONLINE CONTRACTING

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7.1 INTRODUCTION

Online contracts represent the formation of series of contractual obligations in an online environment. From a legal perspective, an online contract follows the same pre-requisite as being followed in offline (physical) contract. At a basic level, online contract formation requires online offer/proposal by one party and its online acceptance by the other party. The entire process of formation of online contract is not simple. One has to trust the technology as well.

7.2 OBJECTIVES

After reading this unit, you should be able to:

- explain the emerging issues concerning contracts formed electronically;
- explain the various features of online contract such as
  a) validity / enforceability of online contracts
  b) capacity to contract
  c) applicability of postal and instantaneous communication rule in online medium
  d) authentication of electronic records
  e) jurisdictional complexities
  f) unconscionable licensing terms
  g) automatic contracts

7.3 ISSUES EMERGING FROM ONLINE CONTRACTING

Electronic contracts, by their very nature, are dynamic and often multi layered transactions. With a layered contract, agreement to a contract may not occur at a single point in time. There exist a chain of successive events – e-offer, e-acceptance, consideration etc., combination of which may lead to electronic contract formation.

E-contract formation has not only given rise to many complexities but also raised certain critical legal issues. It is thus imperative to look into the following issues in view of the emerging law.

7.3.1 Capacity to Contract

To rely on an electronic message, the parties should take steps to make sure the contract is binding, *e.g.*, that the essential terms of the contract are manifested, agreed upon, and that the persons who are parties to the electronic "contract" have the legal competence and capacity to enter into an agreement.

Often it is a nameless individual entering into a contract. The other party (service provider) has no idea whether the individual who has clicked on "I Agree" text or icon is legally competent to enter into a contract. Under the Indian Contract Act, 1872, one of the pre-requisites of a valid contract is that the parties must be competent to contract [sections 10, 11 & 12]. Contracts entered into by individuals, who are not competent to contract are void. There may arise in a situation, wherein infants who are not old enough to enter into a contract are entering into an online contract with the service provider by clicking on "I Agree" text or icon.

Section 11 of the Indian Contract Act, states "…..every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject". Also, under section 3 of the Indian Majority Act, 1875, the age of majority is eighteen years. In other words, reading of sections 10 & 11 of the Indian Contract Act together with section 3 of the Indian Majority Act will make a person below the age of eighteen years, incompetent to contract. However, no section in the Indian Contract Act makes it clear whether, such an agreement if entered into, would be voidable or altogether void.

Nevertheless, in *Mohori Bibee* v. *Dharmodas Ghose* [(1903) 30IA 114], it was settled by the Privy Council that "it is essential that all contracting parties should be competent to contract and a person who by reason of infancy is incompetent to contract cannot make a contract within the meaning of the Act. The question whether a contract is void or voidable presupposes the existence of a contract within the meaning of the Act, and cannot arise in the case of an infant". That is, a minor's agreement is absolutely void or devoid of all effects. Consequently, all the effects of a minor's agreement must be worked out independently of any contract.

Translating the aforesaid decision in online medium, any online contract entered into by a minor would tantamount to be void. Thus, it is imperative that the service provider needs to incorporate the following clause on Membership

Eligibility in its Standard Terms and Conditions:

"Use of the Site is available only to persons who can form legally binding contracts under applicable law. Persons who are "incompetent to contract" within the meaning of the Indian Contract Act, 1872 including minors, undischarged insolvents etc. are not eligible to use the Site."

But the question remain is – would it be sufficient to protect the interests of service provider, who has been wronged by a minor? The answer is in *negative*, in view of the decided case law:

(1) The minor is not estopped from setting up the defence of infancy, for the reason that there can be no estoppel against a statute. This rule applies even if the minor has acted fraudulently (Gadigeppa Bhiwappa v. Balangowda, AIR 1931 Bom 561).

(2) The minor will not be liable for a tort arising out of contract, for the reason that such liability is an indirect way of enforcing his agreement. But where the tort is independent of the contract the mere fact that a contract is also involved, will not absolve the minor from liability (Leslie Ltd. v. Shill, [(1914) 3KB 607]).

(3) The minor cannot even ratify the agreement on attaining majority, as ratification relates back to the date of the making of the contract and, therefore, a contract, which was then void, cannot be made valid by subsequent ratification (Suraj Narain v. Sukhu Ahir, ILR [(1928) 51 All 164]).

Thus in a nutshell, a minor's agreement is always absolutely void. It is obligatory for the service provider to ask for parental consent where children are potential purchasers of online goods or services.

Please answer the following Self Assessment Question.

Self Assessment Question 1 *Spend 3 Min.*

What is meant by capacity to contract?

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Examples of Online Contracts.

7.3.2 E-mail Box Rule

Traditional contract law (common law) does not permit silence or inaction to constitute acceptance. Acceptance requires that an offeree communicate his assent to the terms of the offer. Acceptance may be manifested by acts such as "speaking or sending a letter, a telegram, or other explicit or implicit communication" to the offeror. Even the mere receipt of an e-mail message may constitute acceptance.

The question is – whether e-mail communication fall in the category of postal

rule or instantaneous communication rule? When the sender sends an e-mail message, the message is routed through the mail servers of the Internet Service Providers (ISPs), before being delivered to the recipient. The communication is not instantaneous. In other words, e-mail communication falls under the category of postal rule, i.e., a contract comes into existence when the acceptor puts his acceptance/assent (e-mail message) into transmission so as to be out of the power of the said acceptor. But it is important to note that the acceptor when puts his assent into transmission would assume a role of an originator[1] (of an electronic record) and the law[2] says an electronic record is deemed to be dispatched from the place where the originator has his place of business, which means contract is complete at the place where acceptance is made by the acceptor.

In *Shattuck* v. *Klotzbach* (2001 Mass. Super LEXIS 542), the court enforced a contract that the parties made through a series of e-mails for the sale of real property, in which all of the essential business terms were communicated. The court also concluded that the seller's typed signature at the end of the e-mails constituted authentication of the seller's intent to engage in the transaction.

How about applicability of instantaneous communication rule in online medium? Parties in Electronic Data Interchange (EDI) transactions exchange information on an agreement upon electronic format using proprietary computer networks. The European Model EDI Agreement provides obligations of the parties to ensure authenticity, integrity, confidentiality and non-repudiation of EDI messages. It provides that in an EDI transaction, the contract is concluded at the time and place where the EDI message-constituting acceptance of an offer reaches the computer system of the offeror[3]. That is, EDI contracts fall under the category of instantaneous rule, because the exchanges of e-mails are instantaneous over the proprietary computer networks.

7.3.3 Electronic Authentication

The common law of contract has evolved over a period of many centuries. It has crystallized the concept of "pen-paper-and-signature" as physical means of authenticating a contract. Now, in the online medium electronic authentication has to be seen from the point of "electronic records and digital signatures".

Electronic records need validation under the rules of evidence and procedure. Digital signature provisions are procedural provisions that treat digital signature as equivalent to a handwritten signature. The Information Technology Act, 2000 advocates the use of digital signatures to authenticate electronic records. The said Act provides a legal framework to facilitate and safeguard electronic transactions in the electronic medium. It accepts 'digital signature' [section 2 (1)(p)] as an authentication standard. Section 3 of the Act enumerates the whole process of digital signature creation and its verification. It is based on UNCITRAL's Model Law on E-commerce, which adopts 'functional equivalent approach' advocating a shift from paper-based environment to a computer-based equivalent.

Digital signatures as an electronic authentication standard fulfills all statutory requirements associated with acceptance of handwritten signatures, like purpose, affirmative action, evidence, signer identification etc. It should not be forgotten that the law *does not* recognise digital signatures in a stand-alone environment. It gives recognition to the whole system, i.e., the public key infrastructure

(constituting certifying authorities) including the standards, which create and verify digital signatures.

In an online medium, wherein parties are using digital signatures to authenticate e-mails (electronic messages), it is imperative that the parties exchanging e-mails must seek answers to the following questions before accepting the electronic messages:

(1) Whether the Certifying Authority providing the digital signature is a licensed one?

(2) Whether a digital signature has been created as per the technology standards prescribed under the law?

(3) Whether the digital signature verification process has been successful?

Affirmative answers to all the above questions will give authenticity, message integrity, non-repudiation and confidentiality to the electronic messages received by the parties.

7.3.4 Choice of Law

Courts will apply the law of the jurisdiction that has the most points of contact with the contractual relationship. This is often being referred to as "personal jurisdiction" of the court. It looks into an issue from the point of 'physical presence', whether the person was a resident or a non-resident. If he is a resident, then there is no doubt about his being subject to municipal (domestic) laws. The problem arises, if he is a non-resident, what laws would be applicable – municipal laws of the state where he is residing or municipal laws of the state whose laws he has transgressed? The problem becomes much more complex when it comes to fixing choice of law in an online medium.

Legal principles on personal jurisdiction, like 'Long-arm Statute', 'Minimum Contacts', and 'Due Process of Law' have been increasingly used by the courts in the U.S. to fix the place of jurisdiction in e-business transactions by differentiating between 'passive' and 'interactive' websites.

Passive Websites

A passive website represents an extension of offline business activities in an online medium. The website is meant for information purposes only. It does not solicit business.

In *Bensusan Restaurant Corp.* v. *King* [937 F. Supp. 295 (SDNY, 1996)], where a New York jazz club operator sued a Missouri club owner claiming trademark infringement, dilution and unfair competition over the use of the name "The Blue Note". The defendant maintained a web site promoting his Missouri "Blue Note" club and providing a Missouri telephone number through which tickets to the club could be purchased.

The issue, as framed by the Federal District Court, was whether the existence of the web site, without more, was sufficient to vest the court with personal jurisdiction over the defendant under New York's long arm statute.

The court considered whether the existence of the web site and telephone ordering information constituted an "offer to sell" the allegedly infringing "product" in New York, and concluded it was not. The court noted that, although the web site

is available to any New Yorker with Internet access, it takes several affirmative steps to obtain access to this particular site, to utilize the information contained there, and to obtain a ticket to the defendant's club.

The court found that the defendant did nothing to "purposefully avail" himself of the benefits of New York. There was no evidence of the defendant actively encouraging New Yorkers to visit the site.

Interactive Websites

An interactive website provides information and facilitates purchasing decisions. It purposefully solicits business. It complements offline business activities.

In *CompuServe, Inc*. v. *Patterson* [(89F. 3d 1257 (6th Cir. 1996], CompuServe, an Ohio corporation with its main offices and facilities in Ohio, sued one of its commercial shareware providers, a resident of Texas. The suit was filed in Ohio and the defendant asserted that the Federal District Court in Ohio lacked jurisdiction over him, claiming never to have set foot in Ohio.

The appellate court measured the defendant's "contacts" with Ohio and concluded that jurisdiction was proper because: (a) the defendant had "purposefully availed" himself of the privilege of doing business in Ohio by subscribing to CompuServe and subsequently accepting online CompuServe's Shareware Registration Agreement (which contained an Ohio choice of law provision) in connection with his sale of shareware programs on the service, as well as by repeatedly uploading shareware programs to CompuServe's computers and using CompuServe's e-mail system to correspond with CompuServe regarding the subject matter of the lawsuit; (b) the cause of action arose from Patterson's "activities" in Ohio because he only marketed his shareware through CompuServe; and (c) it was not unreasonable to require Patterson to defend himself in Ohio because by purposefully employing CompuServe to market his products, and accepting online the Shareware Registration Agreement, he should have reasonably expected disputes with CompuServe to yield lawsuits in Ohio.

It is thus obvious from the aforesaid case law that it is the degree of interactivity that separates an interactive website from the passive one, and hence determination of personal jurisdiction by the courts.

Please answer the following Self Assessment Question.

Self Assessment Question 2 *Spend 3 Min.*

What are interactive Websites?

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European Approach to Personal Jurisdiction: The Brussels Regulation

The European approach to personal jurisdiction has found a strong basis in the Brussels Regulation, which became effective on March 1, 2002. The Brussels Regulation has become the established law to resolve disputes concerning jurisdiction and enforcement of judgments in civil and commercial matters. The Regulation is also applicable to resolve online commercial disputes.

Further, to resolve such cross border consumer contractual disputes, the EU Member States became signatories to the Rome Convention, 1980. It decides which country law would apply in contractual disputes. The Convention gave freedom of choice to the contracting parties: "A contract shall be governed by the law chosen by the parties. The choice must be express or demonstrated with reasonable certainty …" (Article 3.1).

Indian Approach to Personal Jurisdiction

The Indian law provides two choices to apply personal jurisdiction, i.e., to apply the law of the forum (*lex fori*), or to apply the law of the site of the transaction, or occurrence that gave rise to the litigation in the first place (*lex loci)*.

The courts do have a judicial right to determine the choice of law by identifying the system of law with which the transaction has its closest and most real connection. There is no bar that law of a foreign country cannot be applied or an Indian party could not be subject to foreign jurisdiction. The emphasis is on to select proper law[4].

7.3.5 Choice of Forum

Choice of forum clause is found in almost all online contracts. It makes a good legal sense for the online service providers to limit their exposure to one jurisdiction only. Defending lawsuits at multiple geographical locations could be both expensive and frustrating. Thus the online service provider has no other choice but to subject themselves to only one set of forum and applicable laws only. The user has no other choice, but to accept the service provider's Standard Terms and Conditions by clicking an on-screen text or icon "I Agree", "I Accept" or "Yes". In *Steven J. Caspi, et al.* v. *The Microsoft Network, L.L.C., et al.* [1999 WL 462175, 323 NJ Super, 118 (NJ App. Div, July 2, 1999)], the user could not use Microsoft Network unless she clicked the "I agree" button next to a scrollable window containing the terms of use. Plaintiffs clicked the "I Agree" button to use Microsoft Network, indicating their assent to be bound by the terms of the subscriber agreement and thus forming a valid license agreement. The Superior Court of New Jersey held that the forum selection clause contained in Microsoft Network subscriber agreements was enforceable and valid.

In business-to-business (B2B) online contracts, choice of forum terms allows parties to fix a forum of mutual choice. It was held by the court in *M/S Bremen* v. *Zapata Off-Shore Co.* [407 U.S. 1, 9-10 (1972)], "is that such clauses (forum selection) are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances".

7.3.6 Doctrine of Acceptance by Silence

Online contracts may also exist in the form of mass-market licenses to download software or shareware programs. Such mass-market licenses are posted on the websites in a standard form. These are enforced if two conditions are met: (1) the user has an opportunity to review the terms of license; and (2) the user manifests assent after having an opportunity to review the terms.

Simply clicking an "I Accept" text or icon may accomplish the manifestation of assent. These days, a growing number of website vendors use a "double click" method, which asks customers whether they are certain that they accept the terms of the license. It is quite likely that the reasonable visitor will click through these icons without reading the license agreement prior to the payment. Nevertheless, there should be right to refund if they (customers) have no opportunity to review a mass-market license or a copy of it before becoming obligated to pay.

7.3.7 Unconscionable License Terms

It is quite common to see online contracts containing unconscionable terms of agreement. The question is – whether these agreements can be enforced, if yes, then to what extent? The basic test is whether the license agreement or term should be invalidated because it is "so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract".

A court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single term or group of terms in an online contract or license agreement.

7.3.8 Mandatory Arbitration Clauses

Often online contracts carry arbitration clause. It may read as follows:

"In case of any dispute or any difference arising at any time between the parties as to the construction, meaning or effect of this agreement or any clause or thing contained therein or the rights and liabilities of a Party, hereunder that cannot be amicably resolved by the Parties shall be settled in accordance with the process of arbitration, shall be referred to a single arbitrator of Indian nationality, in case the Parties can agree upon one, and failing such agreement, each Party shall appoint one arbitrator of Indian nationality, and the two appointed arbitrators shall appoint the third arbitrator, an Indian national, who shall act as the presiding arbitrator. The arbitration shall be held in English and the decision of the arbitrator(s) shall be final and binding. All such arbitration proceedings shall be in accordance with and subject to the provisions of The Arbitration and Conciliation Act (India), 1996."

Would one call such a clause unconscionable and excessive? Would it serve to deter the individual consumer (or Party) from invoking the process, leaving consumers "with no forum at all in which to resolve a dispute?"

The aforesaid arbitration clause though part of Standard Terms and Conditions of a vendor cannot be held as unconscionable and excessive. It gives equal treatment to both the parties. In *Brower* v. *Gateway 2000*, [676 N.Y.S. 2d 569 (N.Y. App. Div. 1998)], a New York court upheld a click-through agreement

that required any dispute arising out of the plaintiff's purchase of a computer and software to be resolved by arbitration. Gateway shipped its personal computers in a box containing a printed warning stating, "This document contains Gateway 2000's Standard Terms and Conditions." The license agreement also stated, "By keeping your Gateway 2000 computer system beyond 30 days after the date of delivery, you accept these Terms and Conditions." One of the clauses of the contract mandated that all controversies arising out of the computer contract were to be arbitrated in Chicago, Illinois, applying the "Rule of Conciliation and Arbitration of the International Chamber of Commerce."

The court upheld[5] the arbitration clause, holding that it did not render the contract an unenforceable adhesion contract. The court stated that because "the consumer has affirmatively retained the merchandise for more than 30 days – within which the consumer has presumably examined and even used the product(s) and read the agreement……the contract has been effectuated".

Problems may arise, if the arbitration clause mentions scope of international arbitration under the London Court of International Arbitration (LCIA) or Conciliation and Arbitration of the International Chamber of Commerce Rules. For an Indian consumer the fee to arbitrate the dispute in such international forums may exceed the price of the goods or service, depriving the consumer of any effective remedy. A court may declare such a clause unconscionable and invalid.

It is thus imperative that the mandatory arbitration clause should take care of following factors[6]:

(1) Whether there exist unequal bargaining power;

(2) Whether the weaker party has an option to opt out of arbitration;

(3) Whether the arbitration clause is drafted with clarity;

(4) Whether the stronger party enjoys an unfair home-court advantage;

(5) Whether the weaker party had a meaningful opportunity to accept the arbitration agreement; and

(6) Whether the stronger party used deceptive tactics.

An online contract containing one-sided arbitration clause that take away many substantive rights without giving consumers meaningful remedies carries a risk of being declared unconscionable by the court.

7.3.9 Automated Contracts

It is possible that an individual's communication in an online medium may be met by the programmed response of a computer, without any immediate human knowledge or intervention. Would such interactions create valid contracts? It has been argued[7] that the courts should not have any difficulty in translating these situations into offer and acceptance. The physical involvement of a machine has no legal consequences because it is held to be only the result of prior human intention. Thus, automated declarations of offer and acceptance are valid.

Interestingly, section 14(1) of the Uniform Electronic Transactions Act (UETA)

of U.S., validates contracts formed by electronic agents, even without human review of the terms and agreements. Contracts may be formed by the interaction of an electronic agent and an individual.

Nevertheless, in an automated transaction, an individual must be given the opportunity for the prevention or correction of errors. An individual seeking to avoid the effect of an electronic record must promptly notify the other person of the error. The person erroneously receiving an electronic record must "return it to the other person" or "destroy the consideration received". The person "must not have used or received any benefit or value from the consideration" received from an erroneous message.

Let us now summarize the points covered in this unit.

7.4 SUMMARY

- The legality of electronic communication process culminating into electronic contracts is also based on common law of contract.
- Electronic contracts, by their very nature, are dynamic and often multi layered transactions.
- In online contracting process, technology is an added dimension and hence, it is important that the contracting parties should be prudent and aware of their obligations and liabilities before they click on on-screen "I Agree" text or icon.

7.5 TERMINAL QUESTIONS

1. It is said, "Online contracting process is quite similar to offline contracting process". Do you agree with this statement? Give reasons.
2. What is meant by 'unconscionable' terms of agreement? Is there a remedy available to a consumer against such terms?
3. Differentiate between interactive and passive websites from the point of applicability of personal jurisdiction.

7.6 ANSWERS AND HINTS

Self Assessment Questions

1. Mohori Bibee v. Dharmodas Ghose.
2. A passive website represents an extension of offline business activities in an online medium.

Terminal Questions

1. Refer to section 7.1 of the unit.
2. Refer to section 7.2 of the unit.
3. Refer to section 7.1 of the unit.

7.7 REFERENCES AND SUGGESTED READINGS

1. Section 2(1)(za) of the Information Technology Act, 2000.
2. Section 13(3) of the Information Technology Act, 2000.
3. Article 3.3 of the European Model EDI Agreement.
4. Sharma Vakul. "Information Technology, Law and Practice", Universal Law Publishing Co. 2004.
5. Rustad Michael L. and Cyrus Daftary. "E-Business Legal Handbook, Aspen Law & Business" 2004. p. 656.
6. Id. at 658.
7. Glatt Christopher. "Comparative Issues in the Formation of Electronic Contracts" (1998) 6 Int JLIT 34.