Blake, Cassels & Graydon LLP May 2008

Blakes Bulletin

Information Technology

What Your Business Must Know About Virtual Worlds

SHELDON BURSHTEIN

WHAT VIRTUAL WORLDS ARE

A new form of video game, called a massively multi-player online role playing game (MMORPG or MMOG), has experienced a meteoric rise in popularity. There are three categories of MMOGs. The first comprises electronic versions of traditional board games, called casual games. These are traditional games, like chess, which participants play online. The second comprises scripted games. These involve large numbers of players interacting with each other in a virtual world within the limits of the creators' pre-existing scripts. These games have a purpose, such as attaining the most points. Participants may play individually or in groups.

The third category comprises unscripted games, called real world games. Real world games, involving virtual worlds or metaverses, are online digital environments in which large numbers of users socialize, participate in events and, in some cases, create and trade virtual goods, services and other property, including virtual real estate. Several real world games create an alternative online virtual world which mimics many facets of real life through interactive computer simulation. In contrast to scripted games, real world games have no pre-scripted story line or purpose. Participants interact with each other in different venues and do what they desire. The only limitations are the computer code and the rules of the game.

Examples of real world games include ACTIVE WORLDS, EVERQUEST, THERE, THE SIMS ONLINE and the mature-themed RED LIGHT CENTER. The largest and best-known virtual world is SECOND LIFE, which was created, and is operated by, Linden Research Inc. or Linden Lab. It also operates TEEN SECOND LIFE. A participant launches Second Life's software on a personal computer, logs in to the site, and then is free to roam endless virtual landscapes, create goods, meet others, and conduct business.

A Second Life user is referred to as a resident and is represented by an avatar. An avatar is an icon or human, humanoid, animal or object representation of a resident in a shared virtual world. Avatars are made by tools provided by the virtual world provider and are defined by their appearance, capabilities, behaviour and communication. An avatar may be completely fictitious or may be made to resemble the resident it represents. Another resident can obtain certain limited information regarding the resident represented by a particular avatar, such as his or her real age. At least one person has sought a trade-mark registration for a personal avatar.

One of the distinguishing characteristics of Second Life is that residents, not Linden Lab, create most of the content. A three dimensional modelling tool allows residents to build virtual landscapes, buildings, vehicles, machines and other objects to use, trade and sell. A resident can mark such a creation as:

(i) "no copy", meaning that no copies may be made by others;

(ii) "no mod", meaning that no characteristics of the object may be modified; or

(iii) "no trans", meaning that the current owner may not transfer the object to another person.

The impetus for many participants' involvement lies in Second Life's thriving virtual market economy. Second Life advertises and promotes the ability of residents to retain ownership of their virtual creations and to own virtual real estate.

In Second Life, Linden Lab does not provide hard currency. However, Second Life participants use a virtual currency known as Linden Dollars, which are freely convertible to real world currency, to effect transactions. Residents use a currency exchange called Lindex, and even a stock exchange has been set up. Linden Dollars may be held as a credit in a resident's account to be applied to account fees, may be used to purchase land, goods or services, or may be withdrawn in real currency.

CONTINUED

CONT'D FROM PREVIOUS PAGE

By late 2007, almost 10 million people were participating in Second Life and effecting transactions which cumulatively involve more than US$1-million daily. Participation is growing by more than 25 per cent each month. At least one person is known to have accumulated a net worth exceeding US$1-million from profits entirely earned in Second Life.

Many major companies, including Adidas, Amazon, American Apparel, American Express, Armani, BMW, Calvin Klein, Circuit City, Coca-Cola, Daimler, Dell, Fiat, General Motors, Herman Miller, IBM, Intel, Kraft Foods, Leo Burnett, Mazda, Microsoft, NBC, Nike, Nissan, Playboy, Reebok, Reuters, Sears, Sky News, Sony, Sprint, Sun, Telstra, Toyota, Wal-Mart and Warner Music, have presences on Second Life, and so do Canadian businesses like Canada Post and Telus. Even financial institutions, among the most staid businesses, are participants, and participating major banks include ABN Amro and ING.

Many well-known organizations and institutions also participate, including the American Bar Association, the American Cancer Society, the Federal Bureau of Investigation, the National Aeronautics and Space Agency, National Public Radio and Save the Children. Participating universities include Harvard, Laval and Princeton. Countries, such as Estonia, Sweden and the Maldives, have opened embassies on Second Life. A private entity has even established a Second Life Patent and Trademark Office.

Businesses have joined for various reasons, for example to:

(i) effect transactions by selling real or virtual goods;

(ii) perform real or virtual services;

(iii) test new product offerings;

(iv) advertise real world goods or services;

(v) build brand awareness; or

(vi) showcase innovation.

Participants are experimenting with various business approaches. By way of example, IBM offered streaming video of the Wimbledon tennis tournament through Second Life in 2007 and enabled avatars to participate. Harvard University offers classes. Artists like Jay-Z have performed concerts.

LEGAL ISSUES GENERALLY

Second Life users are required to agree to terms of service (TOS) by way of a click-through agreement in order to access the site. The TOS serve as the "law of the land" and provide that Linden Lab retains ownership of the account and related data, regardless of the intellectual property rights a user may have in content the user creates or otherwise owns. The user's intellectual property rights do not confer any rights of access to Linden Lab's services or any rights to data stored by, or on behalf of, Linden Lab. All content, currency, objects, items, scripts, equipment or other value or status indicators may be deleted, altered, moved or transferred at any time for any reason at Linden Lab's sole discretion.

The TOS prohibit users from taking any action or uploading any content that infringes or otherwise violates any third party rights or from impersonating any individual or any other person or entity without consent. Second Life bars gambling and has rules against offensive behaviour in public, such as racial slurs or overtly sexual behaviour. However, consenting adults may engage in sexual role-playing. While the TOS set out substantive law, they do not provide a forum or mechanism for justice. Some authors have suggested procedural models, but none has yet been implemented.

Virtual environments and the resulting commercial and other activities which occur within them raise numerous new, interesting and challenging issues. These include issues relating to contracts, e-commerce, consumer protection, supply of goods and services, property, privacy, publicity, defamation, employment, tax, intellectual property, and even family law, as well as the resulting jurisdictional questions that inevitably result. For example, there may be an issue as to whether revenues received in Second Life should be reported for taxation purposes.

Like any community, Second Life has been subject to criminal activity, including theft, fraud, virtual escort activity, sexual harassment, assault, gambling, money laundering and even terrorism and murder. Offenders, referred to as griefers, often victimize new players. Virtual crimes are becoming such a significant problem that Second Life features a community police blotter bulletin board. As real world value is at stake, and many participants have made significant economic and social investments, deviant activity by residents has real

CONTINUED

©2008 Blake, Cassels & Graydon LLP

CONT'D FROM PREVIOUS PAGE

consequences. A resident who has invested the equivalent of real world money to acquire virtual world assets that are destroyed or swindled, suffers real economic loss.

Eliminating crime and other improper activity, which may not have been foreseen by the creators of these games, has proved to be one of the most difficult challenges for Second Life. In Second Life, a three-strikes policy enables Linden Lab to permanently terminate a player's account after three violations of its Community Standards, which govern intolerance, harassment, assault, privacy, indecency and disturbing the peace.

The resolution of disputes on Second Life is in its infancy but there are complicated and unresolved issues. In 2006, the COPYBOT debugging and back-up software tool was edited and recompiled into a new application which could clone avatars and objects created in Second Life without the creator's authorization. This significantly reduced the value of virtual assets by making them readily available even if the creator had identified them as "no copy" objects. Linden Lab responded by announcing that COPYBOT or any similar tool violates Second Life's TOS, which state that users must use Second Life as provided, without unauthorized software or other means of access or use and must not make unauthorized works from, or conduct unauthorized distribution of, Linden Lab's software.

In the first lawsuit between a resident and Linden Lab, the court considered virtual personal jurisdiction and the enforceability of the TOS. In that case, a resident acquired a parcel of virtual land at an unpublished and unauthorized auction through an unauthorized software exploit. Linden Lab considered this to be a fraudulent scheme and, pursuant to the TOS, froze the resident's account and confiscated all of his virtual property and currency. The resident sued Linden Lab and its chief executive officer, alleging unfair trade practices, conversion, interference with contractual relations and breach of contract. The defendants lost a motion to compel arbitration of the case pursuant to Second Life's TOS. The court held that the arbitration clause was unenforceable because it was unreasonable as a contract of adhesion. The case subsequently settled.

Before dealing with the merits, the court concluded that, although Linden Lab is a Delaware corporation headquartered in California, Linden Lab's national advertising campaign and virtual town halls, hosted within the system by an executive of Linden Lab, created sufficient minimum contacts to satisfy the requirements for personal jurisdiction in a Pennsylvania court. The decision suggested that actions in a virtual world may be enough to confer personal jurisdiction on an operator and, potentially, even users, at least insofar as they interact with others in the virtual world. The potential consequence is that a user in a virtual environment may have no way of knowing where other users are physically located in the real world, and thus may have no way of controlling the jurisdictions within which they interact.

INTELLECTUAL PROPERTY ISSUES

Virtual worlds are ripe for intellectual property disputes. The freedom that users have to create virtual assets makes it as easy for them to create and sell infringing items as it is to create original non-infringing items. It is equally simple for users to create and sell unauthorized digital replicas of most major real world content frequently branded with real world trade-marks. Content and brand owners have become prime targets. The misappropriation of well-known trade-marks has become ubiquitous in Second Life.

An issue arises as to how virtual objects and intellectual property should be considered. For example, it is unknown whether someone who makes, sells or uses a virtual copy of a widget patented in the real world commits patent infringement and, if so, in which jurisidiction. Similarly, it is not yet determined whether someone who develops a trade-mark used only to identify goods or services in a virtual world generates enforceable trade-mark rights in the real world. To establish a violation of trade-mark rights, a person must be found to have used a confusing trade-mark, so an issue also arises as to whether virtual use of a trade-mark which is the same as, or confusing with, a real world trade-mark constitutes trade-mark use in the real world. For participants to resolve disputes in a real world court system, virtual property must be used as real world intangible property.

CONTINUED

©2008 Blake, Cassels & Graydon LLP

CONT'D FROM PREVIOUS PAGE

Linden Labs has taken the position that it has the right, but no obligation, to adjudicate disputes between users. Linden Labs states that its staff generally removes content that includes trade-marks without apparent authorization. Any resident may file an abuse report if it sees any other resident making unauthorized use of trade-marks in Second Life. This is one reason why trade-mark owners are increasingly arranging for a representative to become a resident.

There have already been trade-mark and copyright issues and disputes involving Second Life activity between real world businesses. Businesses have addressed Second Life activities which violated real world intellectual property rights in different ways. For example, Apple caused the removal of an unauthorized chain of Second Life stores that replicated Apple's real world stores in minute detail. Furniture manufacturer Herman Miller offered replacement authentic virtual chairs free to those who had purchased unauthorized virtual replicas.

Parties have also resorted to real world courts. The liability of a virtual world operator for the infringing conduct of its users is uncertain. In a United States case, the owner of rights to comic book superheroes sued the operator of an MMORPG for trade-mark and copyright infringement on the basis that the operator facilitated infringement because gamers could create avatars that resembled the plaintiff's superhero trade-marks. The operator's EULA prohibited gamers from assuming a name or likeness similar to those of certain superheroes and actively deleted users that violated the EULA. Before the case settled, the plaintiff's trade-mark claims were dismissed on the basis that any activity with such marks by gamers was purely recreational and was not in a commercial context.

There has also been litigation relating to Second Life. In one case, a group of merchants on Second Life joined to sue a person who is alleged to have copied virtual products of the plaintiffs and represented his products as authentic. The plaintiffs made claims of copyright infringement, trade-mark infringement and unfair competition.

In another case, Eros created adult entertainment products in the form of its virtual beds, which it sells to Second Life users to enable them to have virtual sex. Another person made unauthorized replicas of the beds which it sold on Second Life at a lower price. Eros was successful in *ex parte* motions for permission to issue subpoenas to Linden Lab to discover information about the identity of the anonymous defendant avatar and to issue subpoenas to Internet service providers to seek information about IP addresses used by the defendant, who has since been identified.

As these lawsuits and others are settled or decided, the rights of intellectual property rights owners in virtual worlds will be clarified.

©2008 Blake, Cassels & Graydon LLP

Finders Keepers – Search Engines Benefit from Broad Interpretation of User Rights

RICHARD OWENS

With such great resources of knowledge available through networked computers, powerful search engines have come to be an essential part of our daily lives.

Search engines are the gateways to a wide variety of content – written, graphical, photographic, artistic, video, and musical. Search engines may retrieve data out of its intended context, or provide links to illegal copies or to Web sites that are misleading, fraudulent or infected by malware. And so it is not surprising that litigants are increasingly testing the limits of search engines' freedom to index and display proprietary content. A recent United States appellate decision shows the great significance such cases can have for the development of intellectual property law, and perhaps points the way to a similar result in Canada.

Perfect 10, Inc., a purveyor of pictures of nudes, sued Google because Google's search results returned thumbnail versions of images and, more particularly, of unauthorized copies of Perfect 10 images which were found on the Internet. Perfect 10 argued that Google was liable for direct copyright infringement, because mouse-clicking on a Google thumbnail displayed the full-scale, unlawfully copied version of the Perfect 10 image in a Google frame. On this question, the court ruled that, because Google only "framed" content which was provided from a link to someone else's server, and did not make a copy on any of Google's own servers, Google was not liable for direct infringement. Google itself would have had to actually make a copy in order to be liable for direct infringement of copyright.

Secondly, Perfect 10 alleged that Google should be liable for "contributory infringement" under copyright because it contributed to the display of infringing content by other, unauthorized copiers. In spite of the allegation, it seems from the court record that Google had in fact been fairly scrupulous about following up on Perfect 10's requests to remove unauthorized material from its search results, and that Perfect 10 had not been assiduous in making such requests. On the contributory infringement issue, however, the Court of Appeal sent the matter back for trial for want of evidence and, in doing so, articulated for the lower court a strict test under United States law for a finding of contributory infringement; that is, that it needed to be determined whether or not Google had "actual knowledge that specific infringing materials [are] available using its system", and whether Google nonetheless "continued to provide access to infringing works".

Perhaps still more interesting was Perfect 10's claim of direct infringement on the basis that Google made, stored and transmitted thumbnail copies of the images. There was evidence before the court of a commercial market for such images. Perfect 10 could sell them for mobile device purposes and Google had a commercial interest in making available search results, since they enhanced its advertisement sales revenues.

Despite Perfect 10's commercial opportunities for thumbnails, the court ruled, consistent with its earlier decision in *Kelly v. Arriba Soft*, where there was no commercial value for the thumbnails, that Google's return of thumbnail search results was "fair use" under United States copyright law because it was "highly transformative and of great value". This is a very broad reading of the fair use doctrine. In effect, it is to say that a search engine is entitled to copy an entire work and display it in search results. The court justified its result on the basis of public policy and the important role that search engines and the Internet play in modern society.

The issues before the United States court could be litigated in other jurisdictions. Canada's equivalent to fair use, the right of "fair dealing", was recently radically re-examined by the Supreme Court of Canada in *CCH v. Law Society of Upper Canada*. The views of the court set out in *CCH* might very well allow a result similar to Perfect 10 to be reached in Canada.

In the *CCH* case, the court recategorized the "fair dealing exception" from a defence to infringement to "a user's right". The court set out a number of factors to consider when determining whether the bounds of "fair dealing" had been exceeded. The court held that "the *Copyright Act* does not define what will be 'fair'. Whether something is fair is a question of fact and depends upon the facts of each case." The court then went on to list a number of factors which are to be considered determining whether or not a dealing with the work is fair, including: the purpose of the dealing;

CONTINUED

©2008 Blake, Cassels & Graydon LLP

CONT'D FROM PREVIOUS PAGE

the character of the dealing; the amount of the dealing; alternatives to the dealing; the nature of the work; and the effect of the dealing on the work. It was the view of the court that, in some circumstances, it might be fair dealing to copy the entirety of the work. For example, there might be no other way to criticise or review certain types of work, such as photographs [other than to reproduce them entire]. But generally, for fair dealing, including for "research and private study", the amount taken is indicative of whether a dealing is fair, but not determinative.

Google's creation of thumbnail copies seems clearly to aid research and private study. In *CCH*, the court clearly stated that the fair dealing exception is open to those who can show that their dealings with the copyrighted work are for the purpose of research or private study. "Research" must be given a large and liberal interpretation in order to ensure that users' rights are not unduly constrained.

Therefore, a Canadian court may be inclined to take an expansive view of fair dealing and the rights of users to arrive at the same conclusion as in the *Perfect 10* decision. The result could be reached either on the basis that a search engine's purpose was to aid research, and that therefore the research purpose shelter its activities, or that the engine's work itself amounts to research, that is, finding and retrieving indications of meaning through a vastly distributed, networked information architecture. Whether a search engine's dealing is fair could ultimately depend on the purposes of the individual using its facilities.

©2008 Blake, Cassels & Graydon LLP

Blakes Bulletin
May 2008
Information Technology

Amendments to Withholding Tax Regime

KATHLEEN PENNY AND EDWARD MILLER

When Canadian companies license computer software from U.S. licensors and arrange for maintenance and support services for the software, there are a number of Canadian tax issues to consider.

In connection with the license fee itself, Canadian withholding tax applies at the rate of 25 per cent to rents, royalties and similar payments paid by a Canadian resident to any non-resident of Canada, unless there is an exemption in the *Income Tax Act* (Canada) or an exemption or rate reduction in an applicable tax treaty. The U.S. licensor and the Canadian licensee should determine which party would bear the burden of the withholding tax, if any, and any gross-up clause should be drafted accordingly.

Canadian companies licensing software from U.S. licensors for use in Canada have long been able to avoid withholding tax issues by ensuring the licensor (i.e., the “beneficial owner” of the license fees) is a “resident” of the U.S. for purposes of the *Canada-U.S. Tax Treaty* (the Treaty). Residents of the U.S. were generally entitled to full benefits under the Treaty. The Treaty contains a full exemption from withholding tax in the case of payments for the use of, or the right to use, computer software.

When in force, the Fifth Protocol to the Treaty (the Protocol), signed on September 21, 2007, may instead require the licensor to be a “qualifying person” in accordance with the new limitation on benefits rules in order to still be eligible for full Treaty benefits. Under the Protocol, a qualifying person is a resident of the U.S. who also meets certain criteria set out in the Protocol. Unfortunately, the criteria are complex and may require Canadian companies to conduct further due diligence and obtain additional representations when licensing software from U.S. licensors. Even if a U.S. licensor is not able to satisfy the requirements to be a qualifying person, there are other tests or procedures that may allow the U.S. licensor to quality for Treaty benefits generally or, in certain situations, limited Treaty benefits that would include the benefits relating to license fees for software.

While the Government of Canada has completed the steps required to give effect to the Protocol, the U.S. government has yet to complete such steps and, consequently, it is not clear when the Protocol will amend the Treaty.

With respect to annual maintenance and support fees, such fees are generally for:

1. updates and upgrades, and

2. technical support provided over the phone or by remotely accessing the computer on which the software is installed.

To the extent such fees relate to updates and upgrades for the licensed software, that portion of the fees will be considered part of the licencing fees and treated in the same manner as the license fees (i.e., there will not be any Canadian withholding tax if the licensor is entitled to Treaty benefits). To the extent that the fees are for technical support (if provided from outside Canada), that portion of the fees is for services rendered outside Canada and will not normally be subject to Canadian withholding tax.

In addition to the services described above, a U.S. licensor of software may provide installation and implementation services, as well as training, to the Canadian licensee. To the extent that payments for these services relate to services provided from outside Canada, the payments will not normally be subject to Canadian withholding tax. However, if the U.S. licensor renders these services in Canada, section 105 of the *Income Tax Regulations* will apply and the Canadian licensee will be required to withhold 15 per cent of the fees attributable to these services (excluding amounts for reasonable travel expenses and disbursements). Depending on the extent to which services will be rendered in Canada, the U.S. licensor may consider applying for a Treaty-based waiver of this withholding obligation from the Canada Revenue Agency.

©2008 Blake, Cassels & Graydon LLP

Blakes Bulletin

May 2008

Information Technology

Intellectual Property Licences and Insolvency Laws

REBECCA KATZIN

Amendments to Canada's bankruptcy and insolvency legislation are another step closer to taking effect with the passage, in December 2007, of Bill C-12, "*An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*" (C-12). When proclaimed into force, the amendments will partially clarify the rights of a licensee of intellectual property from an insolvent licensor. However, a number of uncertainties remain.

LEGISLATIVE HISTORY

C-12 is the latest addition to a long-anticipated package of amendments to Canadian bankruptcy and insolvency laws. Prior to C-12 was Bill C-55, which was passed in 2005 but was not proclaimed into force. Amendments intended to correct certain flaws in the 2005 legislation were introduced to the house last spring as Bill C-62, but died when Parliament was prorogued. These amendments were reintroduced last fall as Bill C-12.

THE PROBLEMS WITH INTELLECTUAL PROPERTY LICENCES AND INSOLVENCY LAWS

C-12 is meant to clarify the rights of a licensee of intellectual property in the event of the insolvency of the licensor. Existing Canadian caselaw – most notably the 2005 British Columbia Court of Appeal decision in *New Skeena Forest Products Inc. v. Don Hill & Sons Contracting Ltd.* – supports the view that trustees in bankruptcy and receivers have the power to disclaim a debtor's executory contracts (i.e., contracts with unperformed obligations). The existence of this power suggests that an insolvent licensor (or a receiver or trustee acting on its behalf) could disclaim intellectual property (including software) licences, and prohibit the licensee from continuing to use the licensed intellectual property, even if only to negotiate terms more favourable to the licensor. In the event of any such disclaimer, the licensee may be left with only an unsecured claim for damages arising from the termination of the licence.

Canadian caselaw dealing specifically with IP licences in insolvency is sparse and somewhat inconsistent. In *Re Erin Features No. 1 Ltd.*, the trustee in bankruptcy sought to disclaim an agreement in which the bankrupt Erin Features had granted Modern Cinema Marketing Ltd. exclusive marketing rights in Canada to a film. The B.C. Supreme Court assumed without deciding that a trustee in bankruptcy has the power to disclaim executory contracts, but ultimately concluded that contract at issue could not be subject to disclaimer, on the grounds that the grant of exclusive marketing rights conveyed a property interest that could not be reversed. Although the court avoided an undesirable result, commentators have criticized the court's reasoning as inconsistent with the principle that a licence does not transfer a property interest.

In contrast, in *Re T. Eaton Co.*, which involved a restructuring under the *Companies' Creditors Arrangement Act*, the Ontario Superior Court permitted Eaton's to disclaim an agreement with National Retail Credit Services Company (NRCS) granting NRCS an exclusive licence to supply credit card services to Eaton's customers and to use Eaton's trademarks in connection with such services. NRCS had paid Eaton's a significant amount of money for these rights. When Eaton's sought to disclaim the agreement in the course of its restructuring, NRCS applied to the court for specific performance. In denying the application, Farley J. held that to generally restrict debtor companies from repudiating contracts would constitute an insurmountable obstacle to effecting compromises and reorganizations and, accordingly, NRCS was entitled only to a claim for damages. Citing the English case *Heap v. Hartley*, Farley J. further held that the licences granted were not in the nature of a property interest.

Looking at the policy behind bankruptcy and insolvency laws, the rationale for giving a trustee in bankruptcy powers to disclaim certain types of executory contracts does not apply in the same way to intellectual property licences as it does to contracts for goods and services. To allow a debtor to disclaim an obligation for future delivery of fungible goods or services is reasonable where it promotes a fair compromise among creditors and maximizes overall recovery. The other party to the

CONTINUED

©2008 Blake, Cassels & Graydon LLP

CONT'D FROM PREVIOUS PAGE

contract can take steps to mitigate the event of non-supply (or pre-emptive steps to hedge the risk) that may be unavailable or impractical in respect of intellectual property. Moreover, contracts to supply goods or services depend upon the ongoing viability of the insolvent party's operation and its ability to acquire and deliver the goods or services it purveys. In contrast, in the case of an intellectual property licence, nothing active may be demanded of the insolvent licensor at all, merely forbearance.

Because of the unique nature of intellectual property, to obtain a substitute may be extremely costly or impossible. It is generally not practical to choose a licensor based on its prospective solvency; moreover, it is arguably inefficient to encourage licensees to make such choices. Licensees bargain for the right to use intellectual property and pay for the expectation of continued use, even if there are ongoing royalty or maintenance payments to be made. To upset such arrangements unjustly enriches the licensor and its creditors at the expense of a party that should be treated as a *bona fide* holder for value.

When the amendments come into force, a licensee's right to use intellectual property, including the right to enforce an exclusive use, will be explicitly protected against rejection or disclaimer by the licensor in the course of licensor proposals under the *Bankruptcy and Insolvency Act* or restructurings under the *Companies' Creditors Arrangement Act*. The protection will apply during the term of the licence agreement, including any renewal as of right, subject to the licensee's continued performance of its obligations under the agreement in relation to the use of the intellectual property. The provisions do not protect the licensee against disclaimer of the licensor's other obligations under the licence agreement, such as obligations for ongoing maintenance, support or indemnity. The legislation is silent on whether the licensee has rights to any improvements made by the licensor on the licensed intellectual property post-bankruptcy.

The condition that the licensee continue to perform its obligations under the agreement may give rise to uncertainty in the situation where the agreement includes a licence as well as other arrangements between the parties, such as ongoing technical support, for a single bundled fee. In the event that the licensor disclaims the support obligations, it may be difficult to determine the correct fee that the licensee must pay in order to preserve its right to use the IP in accordance with the requirements of the legislation.

C-12 corrects certain deficiencies in the 2005 legislation, which did not explicitly address the issues of exclusive licences or renewals. Nevertheless, a number of deficiencies and uncertainties remain. In particular, because the amendments address only licensor proposals under the *Bankruptcy and Insolvency Act* and restructurings under the *Companies' Creditors Arrangement Act*, they do not address other circumstances where a trustee in bankruptcy or a receiver appointed over the assets of the licensor seeks to disclaim or terminate the licence or to sell the underlying intellectual property to a third party, free and clear of any existing licence rights. While some commentators do not consider this a risk, others have expressed concern that the proposed amendments still do not adequately protect the rights of licensees in insolvency proceedings.

Additional provisions of C-12 give a court power to order assignment of an insolvent person's contractual rights and obligations to another person who has agreed to the assignment. Although the court is required to consider whether it is appropriate to make the assignment, and the court's power to order assignment expressly does not apply to "rights and obligations that are not assignable by reason of their nature", the scope and extent of these limitations are not clear, particularly with respect to licence agreements. Accordingly, it seems possible that the provisions may permit a debtor-licensee to assign a licence agreement despite a contractual provision requiring the licensor's consent.

CONTINUED

©2008 Blake, Cassels & Graydon LLP

CONT'D FROM PREVIOUS PAGE

THE U.S. APPROACH

The treatment of intellectual property licences under C-12 to some extent parallels that in the United States Bankruptcy Code (U.S. Code). The relevant provisions were developed in the wake of *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, which allowed a bankrupt debtor in possession to reject an intellectual property licence, leaving the licensee with nothing but a claim for damages. The U.S. Code gives debtors a general right to disclaim executory contracts, but provides an exception in section 365(n) for intellectual property licences. Licensees may choose to retain their rights under the licence provided that they continue making any royalty payments due to the debtor, without any right of setoff. While the regime under C-12 has similarities to the U.S. model, it differs in several ways.

In the Canadian legislation, the term "intellectual property" is used but not defined, and thus would appear to include trade-marks, in contrast to the corresponding provisions under the U.S. Code, which do not apply to trade-marks. In the U.S. Code, the trustee is expressly required to provide the licensee upon request with any intellectual property and associated embodiments to which the licensee is entitled, and is prohibited from interfering with the licensee's rights to obtain the intellectual property or embodiments from another entity, thus reducing potential uncertainty around source code escrow agreements. The Canadian legislation is silent on this issue.

CONCLUSIONS

While C-12 resolves some uncertainties around the ability to disclaim intellectual property licence agreements in restructuring proceedings, the proposed amendments do not address circumstances where a trustee in bankruptcy or a receiver appointed over the assets of the licensor seeks to disclaim or terminate the licence or sell the underlying intellectual property to a third party, free and clear of any existing licence rights. As well, the amendments introduce new uncertainties that will need to be worked out in the courts.

Going forward, licensees will want to take steps to ensure that the application of the amended statutes to their agreements is clear, and in particular to separate the licensee's obligations in respect of the use of the intellectual property from other obligations under the agreement (for example, fees for maintenance and support services).

In addition, licensees should continue to consider use of other methods to protect against disclaimer by an insolvent licensor, including source code escrow, drafting the licence agreement in non-executory terms, obtaining an assignment or partial assignment of the intellectual property, taking a security interest in the intellectual property, or contracting with a licensor that resides in a jurisdiction with stronger protections for licensees.

©2008 Blake, Cassels & Graydon LLP

Blakes Bulletin
May 2008
Information Technology

Domain Names: <whoandwhatisnew.com>

ANTONIO TURCO

CYBERSQUATTING

As we move into a world dominated by Web 2.0, it is a fair assessment that the average person would consider that cybersquatting, generally defined as an attempt to profit by reserving and later reselling or licensing domain names which incorporate the name or trade-mark of another, is a practice on the decline. The reality is, however, that cybersquatting appears to be on the rise.

In a press release issued in early 2007, the World Intellectual Property Office (WIPO) noted a 25 per cent increase in the number of domain name disputes filed with it in 2006, as compared with 2005. That number increased by an additional 18 per cent in 2007. Three reasons standout among the possible explanations noted by WIPO for this increase: domain name front running, domain tasting, and domain parking.

Domain name front running is the practice of registering a domain name after covertly determining another party's preference for that name. This type of information can be gathered by monitoring attempts made by an Internet user to determine the availability of a particular name. For example, an Internet user may conduct a search to determine if the domain name <greatnewproduct.com> is available for registration but may not proceed to register it right away. Shortly thereafter, the domain name is registered by the front runner (the party who has been monitoring searches for that domain name). The initial user who conducted the search may chalk this development up to bad luck, or may feel something more nefarious is afoot.

There are several possible motivations behind front running, for example, the front runner may assume that, since the domain name is of interest to one or more Internet users, it has the potential to be monetized or will have value in a resale market, particularly a resale back to the initial user who conducted the availability search.

There are many ways in which a front runner can gather and monitor domain names that are of interest to prospective registrants, including, software (both unauthorized or not, such as plug-ins or shareware) on an Internet user's computer and third party WHOIS query portals. Many individuals suspect that domain name Registrars (and resellers) are involved in front running.

Domain tasting is often related to front running. Domain tasting is a practice whereby a would-be registrant leverages the add grace period (the period during which a registrant can cancel a domain name registration at no charge) to register domain names in order to test their value. During the period, the registrant conducts a cost-benefit analysis to determine if the level of traffic to the domain name is sufficient to offset the registration fee.

If a domain name generates a sufficient level of interest during the tasting period, the registrant may decide to "park" the domain name. Domain parking involves registering a domain name and arranging for users accessing the domain name to be directed to a customized Internet portal or landing site, generally a Web site which has links to products or services. The landing site operator obtains click-through revenue and pays a portion to registrant. In these situations, the registrant's goal is to monetize value by keeping the domain name and obtaining revenue, rather than by selling the domain name.

From a trade-mark owner's perspective, domain name front running and domain tasting present new challenges. In the case of front running, the domain name may incorporate a proposed trade-mark in which the owner has not yet acquired sufficient common law rights that would permit it to succeed in a dispute under the Uniform Domain-Name Dispute Resolution Policy (the UDRP), or similar policies. With respect to domain tasting, existing dispute resolution mechanisms may not be sufficiently timely or cost-effective as the "tasted" domain name may be available again once the add grace period expires (generally five days).

CONTINUED

©2008 Blake, Cassels & Graydon LLP

CONT'D FROM PREVIOUS PAGE

Domain parking is not an issue from a trade-mark perspective unless the registrant uses trade-marks of another, generally as part of the domain name. In such situations, cases under both the UDRP and the Canadian Internet Registration Authority (CIRA) Dispute Resolution Policy (CDRP) have held that domain parking is "bad faith", as defined under the respective policies.

CHANGES TO WHOIS

The WHOIS is a database directory of domain names and relevant contact information maintained by each top-level domain registry (for example, .com, .ca) which lists contact information for each registrant of a domain name registration, including name, telephone number and e-mail address. The information in the WHOIS database is used to allow users to determine the availability of domain names, assisting law enforcement authorities in investigations, and facilitating enquiries and subsequent steps to conduct trade-mark clearances, and to help counter intellectual property infringement.

The Canadian Internet Registration Authority (CIRA) is implementing changes to the dot-ca WHOIS in response to the requirements in the *Personal Information Protection and Electronic Documents Act*. The new CIRA WHOIS policy will provide for more limited disclosure of information for individual registrants as opposed to what will be available for domain names registered by a business or organization.

Unless an individual registrant opts into "complete" WHOIS publication, most of the registrant's personal information (including his or her name) will be kept private by CIRA, except under special circumstances. These special circumstances are limited to official and legitimate requests by law enforcement agencies and judicial bodies, as well as if the domain name is subject to a proceeding under the CDRP. The information available on WHOIS about dot-ca domain names registered by individuals will be limited to several pieces of technical information, including the server Internet Protocol Names/Numbers, registration date, expiration date, "last changed" date, and the name of the Registrar.

By contrast, registrants that are not individuals will be required to make all of the technical and contact information collected at the time of registration publicly available through the WHOIS. Non-individual registrants may make a request to opt out of providing "complete" WHOIS publication. In such cases, CIRA will assess the request against certain to-be-determined-criteria to assess the public good of the request. Approval for any such requests will remain in the sole discretion of CIRA.

Because the new CIRA WHOIS policy limits the amount of personal information about dot-ca domain name registrants available to the public, it will become more difficult for interested parties to correspond with registrants and may make it more difficult for an individual or organization to prove that a domain name was registered by another party in bad faith. In response, CIRA has proposed to establish an administrative process for passing correspondence from interested parties to a particular individual registrant. With respect to issues regarding the added difficulty in establishing bad faith, CIRA proposes to amend the CDRP Rules, to make it easier for a complainant to provide proper evidence in order to prove its case.

The proposed new CIRA WHOIS policy was to be implemented in March 2008, however, CIRA has recently announced that the implementation date has been pushed back to June 10, 2008.

©2008 Blake, Cassels & Graydon LLP

Blakes Bulletin
May 2008
Information Technology

New Consumer Protection Agency for Telecommunications Consumers in Canada

MARIA AMORE

On December 20, 2007, the Canadian Radio-television and Telecommunications Commission (the CRTC), granted conditional approval to a newly-established telecommunications consumer agency known as the Commissioner for Complaints for Telecommunications Services (the CCTS).

The CCTS is an independent agency with a mandate to receive, to facilitate the resolution of, and, if necessary, resolve eligible consumer and small business complaints relating to certain retail telecommunications services offered by CCTS members. Examples of services addressed by the CCTS are: local telephone services, including calling features, long distance telephone services, wireless telephone services, and Internet access services. CCTS is a non-profit corporation funded by, but completely independent of, Telecommunications Service Providers (the TSPs). TSPs that have become members have agreed to abide by CCTS policy in resolving complaints.

When the CCTS was established, membership in the CCTS was voluntary and open to any entity providing retail telecommunications services in Canada. However, the CRTC has since required that all TSPs with annual Canadian telecommunications services revenues exceeding C$10-million are required to become members by February 1, 2008. The current CCTS members are: Bell Aliant Regional Communications LP; Bell Canada; Cogeco Cable Canada Inc.; Eastlink, MTS Allstream Inc.; Rogers Communications Inc.; Saskatchewan Telecommunications; Telus Communications Company; Videotron Ltd.; Virgin Mobile Canada; and Vonage Canada Corporation.

If a consumer has had difficulty resolving a complaint with a TSP that is a CCTS member, the CCTS may be asked to help. If the CCTS determines that the TSP in question has not reasonably performed its obligations towards the consumer, the Commissioner may order the TSP to do certain things to resolve the complaint, within the bounds of the CCTS *Procedural Code*. This service is offered at no cost to consumers.

All complaints to the CCTS must be made in writing, either through mail, fax or by completing the online complaint form found on the CCTS Web site. The CCTS may proceed through four stages of complaint resolution, if the complaint falls within the scope of CCTS' mandate. These stages are as follows:

1. CCTS staff receives and assesses eligibility of the written complaint.

2. If the complaint is eligible, the staff will forward a copy of the complaint to the TSP member with a resolution response, with a copy to the complainant. The TSP member is granted 20 business days to address the proposed resolution.

3. If the complainant indicates after the 20 business day period that the complaint remains unresolved, the CCTS staff will investigate and make a non-binding recommendation to the complainant and the TSP for the resolution of the complaint. The TSP member may challenge the complaint.

4. If either the complainant or the TSP member rejects the CCTS recommendation and the complaint remains unresolved 20 business days following the date of the recommendation, then the Commissioner will render a decision that becomes binding on the TSP if the complainant accepts it. The complainant may reject the decision and pursue redress elsewhere; however, if the complainant accepts the decision, he/she must sign a release. Decisions (accepted or not) will be publicly available indicating the TSP's identity, but not the identity of the complainant.

If the Commissioner determines that the TSP did not act reasonably pursuant to the applicable contract, then he or she may recommend that the TSP:

- provide the complainant with an explanation or apology; and/or
- undertake to do or cease doing specified activities with respect to the complainant; and/or
- pay the complainant monetary compensation in an amount not to exceed C$1,000 in the aggregate in relation to any one complaint or combined related complaints. Amounts to be refunded or credited to the complainant as a result of billing errors do not constitute monetary compensation and would not be subject to the above compensation limits.

The Commissioner may order any of the remedies available at the non-binding recommendation stage, subject to any applicable contractual limitations of liability.

©2008 Blake, Cassels & Graydon LLP

Canada's National Do Not Call List – Still Under Development

MARIA AMORE

The Canadian Radio-television and Telecommunications Commission (CRTC) regulates telecommunications in Canada pursuant to the *Telecommunications Act*. In June 2006, *An Act to Amend the Telecommunications Act* (Bill C-37) came into force, granting the CRTC the power to establish a National Do Not Call List (National DNCL) in Canada. This Act empowers the CRTC to administer databases for a National DNCL or to delegate its powers in relation to establishing and maintaining such a list in Canada. The CRTC initiated several proceedings and is still in the process of examining the implementation of the National DNCL; it is not yet certain when it will be operational, but the CRTC estimates September 30, 2008.

In 2007, the CRTC set up a comprehensive framework for the creation of this National DNCL, which included the rules with respect to this list, the Unsolicited Telecommunications Rules, Telemarketing Rules and Automatic Dialling-Announcing Device Rules.

At the end of 2007, the CRTC announced that it had awarded a five-year contract to Bell Canada, making it the "operator" of the National DNCL. The operator of the National DNCL will be responsible for such tasks as:

- registering telephone numbers,
- providing the updated versions of the list to telemarketers, and
- receiving consumer complaints regarding telemarketing calls.

These operations will be funded by the fees that telemarketers will pay to subscribe to the National DNCL. Furthermore, in January 2008, the CRTC announced that it would delegate the investigative powers for complaints relating to the National DNCL and telemarketing complaints. This third party will be chosen pursuant to a request for proposals. All telemarketers will pay a fee to the investigator to cover its costs.

The National DNCL will be a nationwide registry that will allow Canadians to reduce the number of unsolicited telemarketing calls they receive. Currently, each telemarketer has its own "do-not-call list", for which Canadians must register separately to avoid unsolicited calls. With the National DNCL, Canadians will simply have to register their number on this one list. There will be no cost to consumers to register on the National DNCL list. Certain organizations will be exempt from the National DNCL, such as registered charities, political parties and businesses with whom a business relationship exists.

Go to **blakes.com/english/subscribe.asp** to subscribe to other Blakes Bulletins.

Blakes periodically provides materials on our services and developments in the law to interested persons. If you do not wish to receive further bulletins or other materials from Blakes, please contact Blakes Marketing Department at 416.863.3036 or dorothy.byers@blakes.com. For additional information on our privacy practices, please contact us at privacyofficer@blakes.com. Blakes Bulletin is intended for informational purposes only and does not create a lawyer-client relationship. The transmission of this information does not suggest Blakes or any of its lawyers are practising law of any jurisdiction other than Canada. The information provided in this bulletin is summary in nature and does not constitute legal advice. We would be pleased to provide additional details or advice about specific situations if desired. For permission to reprint articles, please contact Blakes Marketing Department at 416.863.2403 or lynn.spencer@blakes.com.©2008 Blake, Cassels & Graydon LLP.