techLAW

where business, technology and law converge

A Publication of

FARRELL FRITZ, PC

Trusted advisors to Long Island's leaders

Issue 2, Volume 2
Spring 2001

To Tax or Not to Tax?

By Seth W. Krasilovsky
skrasilovsky@farrellfritz.com

Benjamin Franklin once wrote, "[I]n this world nothing is certain but death and taxes." While taxes may have been a certainty in Benjamin Franklin's world, the same cannot be said in the realm of the Internet and e-commerce.

In October 1998, the United States Congress enacted a three-year moratorium, entitled the Internet Tax Freedom Act ("ITFA"), which (i) banned the creation of certain new state and local government taxes on Internet sales or access, (ii) created a 19-member Advisory Commission on Electronic Commerce to explore the issue of Internet taxes, and (iii) prohibited states and local governments from imposing multiple taxes on Internet transactions without providing credit for taxes paid in other jurisdictions. The ITFA did not, however, result in a tax-free Internet.

The measure permits states that were already collecting Internet access charges before the act took effect in 1998 to continue to do so under the moratorium's grandfather clause. The moratorium does not give the Internet a tax preference, but merely prevents discrimination against the Internet. It does nothing to interfere with state or local governments' ability to levy regular sales or use taxes on items bought over the Internet. Although the moratorium allows states to collect existing sales taxes on Internet purchases, states do not typically enforce collection mechanisms because of the difficulty of getting online shoppers to pay up, and the logistical complications inherent in a system involving more than 7,600 taxing jurisdictions nationwide.

Online sales currently enjoy the same status as mail-order catalog sales. As such, a state may not force an online retailer to collect sales taxes unless the company selling the product or service has a physical presence, such as a store or a warehouse, in the same state as the person purchasing the product or

continued on page 5

Updating Our Focus

Our first three issues of *techLAW* proudly proclaimed that we were "the link between the law and dot.commerce." If you look at our masthead, you may notice a new tagline: "where business, technology and the law converge."

As we represent our clients, many of whom are traditional businesses such as banks, closely-held businesses or not-for-profit institutions, we noted a trend. While attorneys sometimes speak of technology as a separate area of the law, our clients showed us that technology was intertwined in every business discipline (although there certainly is a distinct and evolving field of specific Internet-related legislation and caselaw). Technology affects how human resource managers operate, how financiers lend money, and how marketers distribute information. Technology affects every aspect of the law, and so affects all our clients, every day.

continued on page 2

Retrieval of Employee E-Mail Does Not Violate Privacy

By Michael J. Healy
mhealy@farrellfritz.com

Over the past decade various technologies have helped transform the workplace, facilitating the transmission of information and in the process enhancing productivity. And few of those technologies have had as a dramatic impact in the workplace as e-mail communication. But one aspect of e-mail communication in the workplace - the propriety of employer monitoring and accessing of employee e-mail - has remained less certain.

Until recently, that is.

continued on page 5

Inside This Issue

FARRELL FRITZ, PC
EAB Plaza
Uniondale, NY 11556-0120
(516) 227-0700
www.farrellfritz.com

Disclosures for Consumers Borrowing on Net:

Federal Reserve Board Publishes Rules Clarifying Disclosure Requirements

By Stephen F. Melore
smelore@farrellfritz.com

The Federal Reserve Board ("Board") recently published final interim rules amending certain consumer protection regulations. These rules are consistent with the change in business practices which have occurred as a result of the Internet. Consumers are more frequently applying for credit over the Internet. The Board believes the interim final rules should reduce the costs to institutions in complying with federally mandated consumer disclosures without comprising the effectiveness of the disclosures to the consumer.

The recently revised regulations include:

- Regulation B - Equal Credit Opportunity
- Regulation E - Electronic Fund Transfers
- Regulation M - Consumer Leasing
- Regulation Z - Truth in Lending
- Regulation DD - Truth in Savings

The purpose of the final interim rules is to establish uniform standards for the electronic delivery of federally mandated disclosures. Pursuant to the Electronic Signatures in Global and National Commerce Act ("E-Sign Act") which was enacted in June of 2000, financial institutions, lessors, and other creditors may provide those disclosures electronically provided that the creditors receive the consumer consent.

The final interim rules are consistent with the 1999 proposals of the Board with respect to the same subject matter except that the 1999 proposals generally required that paper disclosures be provided to the consumer in transactions conducted in person.

Assuming the creditors receive the consent of the customer to provide disclosures electronically, the final interim rules permit creditors to make disclosures by e-mail (designated by the consumer) or to make disclosures available at an Internet Web site. Prior to obtaining the customer's consent, the creditor must provide specific information about electronic delivery of disclosures. Disclosures which appear on an Internet Web site must be available for at least 90 days. The interim final rules require that the consumer be required to access disclosures prior to becoming obligated for the particular credit. Accordingly, in the event a consumer is applying for credit on a Web site the creditor must present the disclosures on the Web site prior to the consumer becoming obligated with respect to the credit. The rules do not permit the creditor to provide a link or other bipassable navigation tool that gives the consumer the option of receiving the disclosures. The Board believes this optional approach would reduce the likelihood that the consumer would review the disclosures.

Creditors are also required to take reasonable steps to effectuate delivery in some alternative means in the event an e-mail disclosure is returned as undeliverable. The creditors may send the disclosure to a different e-mail address or a postal address that the creditor has on file for the consumer. It is important to note that the creditor is only required to successfully transmit the e-mail to the consumer. The failure of the consumer to be able to access the e-mail due to technical difficulties with the consumer's software, for instance, does mean that the creditor has failed to deliver the disclosures to the consumer.

> ***...rules require that the consumer be required to access disclosures prior to becoming obligated for the particular credit.***

The interim rules became effective on March 30, 2001. However, to allow for necessary operational changes, compliance is not mandatory until October 1, 2001. Until June 1, 2001 the Board is soliciting comments to determine whether any further statutory or regulatory changes that are needed with respect to the final interim rules and to determine whether the Board should exercise its authority under the E-Sign Act to make rules interpreting the consumer

consent provisions and/or the provisions of the E-Sign Act as they affect the Board's consumer protection regulations.

Stephen F. Melore is a Partner in the Corporate and Banking Department of the firm, and concentrates his practice in general corporate practice with particular emphasis on secured lending and mergers and acquisitions.

Updating Our Focus

continued from page 1

For example, this month litigator Michael Healy looks at how an employer may retrieve stored e-mails of an employee. Partner Kathleen Tomlinson also looks at how technology affects employment issues by studying the revisions that have been implemented in HIPAA since the new administration has taken over in Washington. Trust and estate attorney Seth Krasilovsky reviews taxation on the Internet. Partner Stephen Melore discusses how banking regulations will be applied on the 'Net, while attorney Lyle Mahler studies how the electronic delivery of proxy materials is changing how the securities industry operates. Lastly, regular *techLAW* contributor Eric Penzer takes a look at the insurance industry online.

techLAW editor and partner James Wicks will continue his review of domain names in a new regular feature entitled "Domain Dope."

Our focus has always been the businesses and institutions that have built Long Island. The focus of *techLAW* simply looks at how technology and the law affect how you do business every day. Let us know if you have any comments! Where do business, technology and the law converge? Right here in the pages of *techLAW*.

Bulletin Gives Guidance to States on Insurance

Policy on Provision of Insurance on Net Provided in NAIC's Model Bulletin

By Eric W. Penzer
epenzer@farrellfritz.com

On April 1, 2001, the National Association of Insurance Commissioners ("NAIC") adopted a model bulletin providing guidance to states with respect to several regulatory issues relating to the provision of insurance over the Internet. States have the option of whether to adopt the bulletin.

The NAIC is the organization of insurance regulators from the 50 states, the District of Columbia, and the United States territories. According to the NAIC, one of its purposes is to provide a forum for the development of uniform policy with respect to insurance issues when uniformity is appropriate. The NAIC offers guidance to states through its "model bulletins."

The NAIC's recent bulletin was not intended to provide guidance with respect to every regulatory issue concerning procuring insurance over the Internet. Indeed, the NAIC stated in the bulletin that "[f]urther guidance will be provided as the medium and the structure of the industry's involvement with this medium evolves." The following six discrete issues are addressed in the bulletin: jurisdiction and licensing, advertising, format, record retention, delivery requirements, and privacy.

Jurisdiction and Licensing

With respect to jurisdiction and licensing, the NAIC urges states not to assert jurisdiction over a Web site owner or operator merely by virtue of the existence of a Web site. In other words, the NAIC does not consider the mere maintenance of a Web site to constitute "doing business" within a particular state. This conclusion is consonant with decisional authority emanating from the courts, pursuant to which the owner of a "passive" Web site (*i.e.*, one that is informational only and does not allow the transaction of business) will not be subject to personal jurisdiction merely by reason of the ownership of such a Web site. However, under the NAIC's bulletin, and developing caselaw, personal jurisdiction may be found to exist where the owner solicits, sells, or negotiates insurance online. The line between conducting business online and merely providing information can often be difficult to define, as the caselaw demonstrates.

Advertising

Regarding advertising, the NAIC instructed that Internet advertising should be regulated in the same fashion, and subject to the same rules, as advertisements in other media. By way of example, if the content of a Web site is changed in a manner that would require regulatory re-approval if the advertisement were in print, then the changes to the Web site would also require re-approval. Changes that do not affect the substantive content of the Web page, however generally require no re-approval.

Format

With respect to format issues, the NAIC advised that the appearance of content on a computer monitor is, in large part, a matter beyond the direct control of regulatory agencies. Accordingly, requirements originally established for printed documents, e.g., regarding the use of a specific color or font, would be satisfied if the Web site content "has the same emphasis or distinguishing percentage proportions for the characters relative to the rest of the document."

Record Retention

The NAIC also addressed the issue of online record retention which, according to the bulletin, should be subject to the same standards as in other media. A state should find a regulated entity in compliance with record retention requirements if the entity can reassemble the original information upon request. If there is no written communication between the entity and the consumer, the regulated entity would be in compliance with existing record keeping requirements if it has the ability to produce the information or data accurately reflecting the communication.

Policy Delivery

With respect to policy delivery, the NAIC made clear that the burden is on the regulated entity to satisfy all existing requirements for delivery, irrespective of the method of delivery. Electronic delivery should not be precluded if the parties to the transaction so agree.

Privacy

Finally, regarding privacy laws, the NAIC instructed that privacy laws are equally applicable to all media, including electronic media.

Of course, the issues addressed in the NAIC's model bulletin are merely illustrative of the various issues that have arisen, and will continue to arise, as the Internet becomes an indispensable marketplace for services. Standards governing the interaction between existing industry-specific regulations and the regulations governing eCommerce in general will likely evolve over time, although guidelines such as those approved by the NAIC may prove helpful in charting courses of conduct.

Eric W. Penzer is an Associate in the Commercial Litigation Department.

Employers Breathe Sigh of Relief on Final HIPAA Privacy Rules

Although Debate and Controversy Continue as Regulations Roll Out

By A. Kathleen Tomlinson
ktomlinson@farrellfritz.com

On April 12, 2001, President Bush, much to the surprise of many political insiders, directed Health and Human Services Secretary Tommy Thompson to allow a federal rule protecting the privacy of medical information for millions of Americans to become effective. These tough federal health privacy rules were formulated in the last month of the Clinton Administration under the Health Insurance Portability and Accountability Act ("HIPAA") and established some rather stringent standards for how the healthcare industry and its business partners must protect patient data.

New Privacy Rules

The widespread use of computers has made it easier to share and access medical information. Federal officials are hoping that the new privacy rules will avoid invasions of privacy by guaranteeing patients the right to inspect, copy, and correct their medical records, by demanding written consent from patients before those records can be shared and by requiring health-care providers to establish extensive privacy procedures. Despite intensive lobbying by the healthcare industry, including the American Hospital Association, the final rules protect all medical records and individually identifiable health information "in any form," including written, electronic and oral communications.

> ***...the final rules protect all medical records and individually identifiable health information "in any form," including written, electronic and oral communications.***

Employment

Most Employers Off Hook

Noticeably absent from the final rules is the listing of employers as "covered entities" under the regulations — leaving the majority of employers with a deep sense of relief. Small businesses in particular have been concerned that they could not afford the equipment and training necessary to comply and that some of the proposed rules would have been so burdensome as to put small employers out of business. However, not all employers are off the hook.

Who Must Be Concerned with Revised Regs?

Covered entities under HIPAA include health plans, health care clearing houses, and health care providers that conduct all

continued on page 6

SEC Approves Electronic Delivery of Proxy Materials

By Lyle C. Mahler
lmahler@farrellfritz.com

Continuing its ongoing, yet guarded, move into the electronic age, the Securities and Exchange Commission ("SEC") has recently approved a rule change to Section 402.04 of the New York Stock Exchange Listed Company Manual ("Manual") in order to permit New York Stock Exchange listed companies to deliver proxy materials electronically. The rule change, which was granted accelerated approval, took effect on April 5, 2001.

As amended, Section 402.04 of the Manual makes it possible for listed companies to arrange for the delivery of its proxy materials by electronic means to beneficial owners of the company's shares, provided the beneficial owners have given their prior written consent to such delivery. Such consent may be made by means of e-mail. One possible method of delivering proxy materials by "electronic means" includes (but is not limited to) posting such materials on the company's web site, with an e-mail notice to the beneficial owner advising of the availability of such posting on the web site. In addition, the rule change will allow beneficial owners to deliver their proxies by electronic means as well.

Under the amended rule, listed companies (as well as intermediaries acting as nominees for beneficial owners) and beneficial owners will be permitted to use electronic means to deliver proxy materials and proxies provided they otherwise comply with all applicable federal and state laws, including interpretative releases issued by the SEC. Accordingly, all electronic deliveries accomplished under the amended rule would have to comply with the requirements set forth in these interpretations and any future interpretations that the SEC may issue on this subject matter. To date, the SEC has issued three interpretations regarding electronic delivery requirements under the federal securities laws. (*See techLaw*, Issue 2, Vol. 1, for further discussion on prior SEC rulings in this area.)

Securities

Overall the SEC anticipates that the rule change will allow issuers and investors to utilize new technology to deliver documents required under the Securities and Exchange Act in a more efficient manner. Not only should issuers realize savings on postage and printing costs, but investors theoretically should receive their proxy materials sooner than is otherwise possible by current delivery methods.

Lyle Mahler is an Associate in the Corporate and Banking Department of Farrell Fritz and represents banks and public corporations.

Retrieval of Employee E-Mail Does Not Violate Privacy

continued from page 1

The courts are now beginning to address the question of an employer's right to monitor and access employee e-mail, and the answers the courts are reaching are as clear as they are consistent: provided that the employer does not actually intercept or access an employee's e-mail "in the course of transmission," an employer does not violate any federal or state wiretap law by retrieving the employee's e-mail.

Fraser v. Nationwide Mut. Ins. Co., recently decided by Judge Anita Brody of the United State District Court for the Eastern District of Pennsylvania, addressed workplace e-mail privacy issues under federal and state wiretap laws - and illustrates how the courts are grappling with the issue.

The plaintiff in *Fraser* was a former employee of the defendant, an insurance company. While employed by the defendant, the plaintiff had drafted a letter warning that the company's agents would leave because of what the plaintiff asserted were the company's objectionable policies and practices. The company terminated the plaintiff's employment when, after searching the employee's stored e-mail, it discovered that he had sent the letter to a competing insurance company. The plaintiff then sued, alleging, among other claims, that the company unlawfully intercepted his e-mail communication when it retrieved his e-mail from the company's electronic storage sites, in violation of federal and state wiretap statutes.

Analyzing the federal and state wiretap statutes, Judge Brody concluded that the employer did not act illegally and dismissed the plaintiff's claims. "The strong expectation of privacy with respect to communication in the course of transmission significantly diminishes once transmission is complete," the Judge wrote. And the federal and state wiretap laws provide protection for communication only while in the course of transmission, the Judge found. While calling the employer's actions "ethically questionable," Judge Brody concluded that they were not legally actionable under the wiretap statutes since, she determined, the e-mail was retrieved from storage after transmission was complete, not in the course of transmission. There was, therefore, no "interception" for purposes of the wiretap statutes.

Just when is an employer's interception or monitoring of employee e-mail actionable under the wiretap laws? The circumstances appear limited. The wiretap laws are violated, Judge Brody concluded, when an e-mail is intercepted from "intermediate storage" or "back up protection storage" - both of which automatically occur during the course of transmission - or if the e-mail is viewed before the intended recipient has a chance to

open it. But once an e-mail has been viewed by the recipient, as Judge Brody found in *Fraser*, the wiretap laws do not prohibit subsequent viewings - whether authorized or not - by a third party accessing it from storage.

The time may come when Congress and the state legislatures might limit the ability of an employer to access e-mail stored for a period of time after its transmission is completed. Until then, however, at least one court has now determined that existing law provides employers with the virtually unfettered legal right to monitor and read workers' stored e-mail communications.

Michael J. Healy is Counsel in the Commercial Litigation Department.

To Tax or Not To Tax?

continued from page 1

service. In fact, two rulings by the U.S. Supreme Court blocked a state from forcing remote sellers to collect sales taxes unless the seller has a physical presence within the boundaries of the state.

The current moratorium on the taxation of Internet is to expire October 21, 2001. Members of Congress have introduced the Internet Non-Discrimination Act (INDA), which would extend the current moratorium on new, special and discriminatory Internet taxes until October 2006 and would permanently ban Internet access taxes.

In general, a discriminatory tax is a tax imposed by a state or local government which:

- would not have been imposed at all
- would have been imposed at a lesser rate, or
- would have otherwise qualified for less oppressive tax treatment, had the transaction been effected through other means.

Significantly, the INDA would also remove an exemption granted to those states under the grandfather clause of the Internet Tax Freedom Act.

Although the Senate Commerce Committee was tentatively scheduled to act on the proposed legislation during the first week of May 2001, a planned markup of the bill was postponed indefinitely in an attempt to find a detente from the bitter and divisive debates about taxation in the remote sales context (e.g., a sale over the Internet when the seller

or provider of services does not maintain a physical presence in the same state as the buyer of the product or service).

As government and private industry continue to wrestle with the cyber-tax question, Benjamin Franklin's certainty about death and taxes seems to have been left on the shoulder of the information superhighway.

Seth W. Krasilovsky is an Associate in the Trust and Estate Department.

Employers Breathe Sigh of Relief on Final HIPAA Privacy Rules

continued from page 4

billing and fund transfers. Although originally covered, employers were dropped from the final rules, unless the employer is self-insured and thereby acts as the Plan Sponsor. Employers need to be careful not to place themselves in circumstances which could transform them into a covered entity. If your HR representative's only function is to perform enrollment activities, then you are not likely to lose your exempt status. However, if your business self-administers a cafeteria plan or your business performs substantial administrative functions for its Plan (*e.g.*, carrying out payment and operations functions), or if you operate an Employee Assistance Program on the premises and have doctors and psychologists on staff who do the work, your business (or at least that component part of your business) will be considered a covered entity, and you will need to comply with the new rules. This coverage requires an employer to adopt written privacy procedures, train employees who are involved in handling protected information, designating a privacy officer responsible for compliance and establishing a complaint/grievance procedure.

Rules Roll Out

HIPAA has a three-part set of rules. The regulations relating to e-commerce were previously issued and mandate certain technologies such as Electronic Data Interchange. The privacy rules have been much more controversial. The third set of rules — those dealing with security — have not yet been issued in final form, and are also expected to stir vigorous debate among hospitals and health care organizations.

What Happens Next?

The new rules, however, may not remain completely intact. President Bush has directed the Department of Health and Human Services to recommend changes that will make the rules more palatable to hospitals, drug companies, and insurance carriers. At the moment, however, civil and criminal penalties remain very much a part of the legislation. The Office for Civil Rights (OCR) is the component responsible for implementing and enforcing the privacy regulations. Stay tuned . . ..

Kathleen Tomlinson is a Partner in the Commercial Litigation Department, concentrating on labor and employment issues for private and public companies and institutions.

Domain Dope

By James M. Wicks
jwicks@farrellfritz.com

The Internet Corporation for Assigned Names and Numbers ("ICANN") has reached agreement with the companies that will be charged with operating two new generic top-level domain names (i.e., ".biz" and ".info"). These are the first two of seven -- the other five are ".aero", ".coop", ".museum", ".name", and ".pro" -- new top-level domain names approved by ICANN in November 2000.

Two rulings by the World Intellectual Property Organization ("WIPO") determined that the trademark holders in these cases were being overly aggressive in attempting to stop alleged cybersquatters, characterizing such conduct as "reverse domain name hijacking". The tribunal in both cases, concluded that the evidence showed that trademark holders brought the proceeding, fully aware that the respondents were not "cyber-squatters," but were rather using the domain name to conduct legitimate business. The rulings send a strong message to trademark holders that the Uniform Domain Name Dispute-Resolution Policy cannot be used in bad faith to prevent domain-name holders of their registered names.

Washington State is considering the creation of ".xxx" as a generic top-level domain name for the purposes of including all pornographic sites. If adopted, the measure is likely to be presented to the U.S. Congress.

Verisign will begin registering domain names in several languages, such as Arabic, Hebrew and Thai, which will allow domain names to be registered in all language characters. Until last fall, web site addresses had to be written in Roman characters.

Domain registrars are not liable for allowing registration of domain names that would otherwise be actionable under the Anticybersquatting Consumer Protection Act, so says a federal district court in Texas.

James Wicks is a Partner in the Commercial Litigation Department, and is Editor of techLAW.

techLAW

techLAW is published quarterly by Farrell Fritz, P.C. Farrell Fritz, one of Long Island's largest law firms, serves large and small businesses, institutions, municipalities and individuals in corporate, banking, litigation, real estate, new media, land use, environmental, bankruptcy, tax, employment and trusts and estates matters. If you have any comments or suggestions, please contact our Editor, James M. Wicks.

EDITOR
James M. Wicks, Esq.
(516)227-0617
jwicks@farrellfritz.com

MANAGING EDITOR
Melissa Kane, Marketing Director
(516) 227-0623
mkane@farrellfritz.com

FARRELL FRITZ, PC
EAB Plaza
Uniondale, NY 11556
(516) 227-0700
www.farrellfritz.com