

NEWS



BUSINESS LAW

LETTER

MSBA SECTION OF BUSINESS LAW

Vol. 11 No. 1
Winter 2008

<http://www.msba.org>

Chair's Report

By Eric G. Orlinsky
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Dear Fellow Business Lawyers:

The Section has been hard at work now for several months and has made steady progress on a number of issues that I reported to you in the Summer issue of our Newsletter.

Our Section Technology Subcommittee, Chaired by Bill McComas, has been working with the MSBA staff to improve our web presence. Some of the changes we have requested have already been made, including each subcommittee having its own web page. We have been successful in establishing a satellite video-conference meeting location for each of our Section Council meetings this year in the DC suburbs and we are now moving the satellite location to Rockville. Thanks go to the McGuire Woods and Miles & Stockbridge firms which have generously provided us with the use of a conference room and video equipment for this purpose. This video link allows us to reach out to and better engage our Maryland colleagues in the DC suburbs.

Our Fall Meeting Planning Subcommittee, Chaired by Debbie Diehl, is planning a stand-alone Business Law Section Fall Meeting (probably sometime in October or November of 2008) to provide all day CLE to Section members with various tracks depending on attendee experience level, together with a Section cocktail event and dinner open to all members who attend. In response to feedback from our members that the Section should provide access to more CLE on-line, we hope to provide the Fall Meeting CLE by webcast, live and in a manner that will allow members to download it and view it at their convenience. Hopefully, this will allow members who cannot conveniently travel to the Fall Meeting to nonetheless access and benefit from this program.

The Section Council is also working with SDAT on a couple of projects. One item under discussion is the possibility of a "super" expedited service level for SDAT filings. Another is whether legislation should be considered to address situations where unauthorized parties unintentionally make filings terminating entities belonging to others. In addition, members of the Section Council are working with SDAT alongside members of the Real Property and Tax Sections to craft regulations to implement the Controlling Interest Legislation passed during the 2007 Special Legislative Session.

Many of our subcommittees continue to be very active. In particular, the Securities Law Subcommittee commented to the SEC on recent proposed regulations involving private offerings under Regulation D. The Franchise and Distribution Subcommittee recently held a joint meeting with the IP Section. The Emerging Companies Subcom-

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Conducting A Risk Assessment as Part of A Corporate Compliance Program

By Gregory Yawman
Miles & Stockbridge P.C.

Following the application of the Federal Sentencing Guidelines (the "Guidelines") to business organizations in 1991, public and private corporations adopted corporate compliance programs to prevent and detect criminal conduct by employees. Under the Guidelines, significantly reduced sentences for criminal convictions are possible when a corporation has in place an "effective compliance and ethics program." UNITED STATES SENTENCING COMMISSION, Guidelines Manual, §8B2.1 (2007). In addition, the Department of Justice Criminal Resource Manual directs prosecutors to consider whether a corporation has an effective compliance and ethics program in determining whether to charge a corporation with a criminal offense. Although the mandatory aspect of the Guidelines was struck down by the Supreme Court in *United States v. Booker*, 543 U.S. 220 (2005), the Guidelines continue to play an important role in charging decisions and sentencing by courts and prosecutors. The oversight requirements of the Sarbanes-Oxley Act further affirm the significance of compliance programs for public companies.

In 2004, the Guidelines were amended to emphasize the need for an "effective" compliance program. An effective program focuses upon risk assessment as an ongoing requirement, as the Guidelines provide that the organization "shall periodically assess the risk of criminal conduct" and shall take appropriate steps to design, implement or modify its program based on a risk assessment. Guidelines, at §8B2.1(c).

The Guidelines specify that a risk assessment must include consideration of (1) the nature and seriousness of potential criminal conduct, (2) the likelihood that certain criminal conduct may occur and (3) the prior history of the organization. *Id.* at n.6. With this information, the organization should prioritize its risks to focus on preventing and detecting the most serious and most likely offenses to occur. Finally, the organization must modify its program to address the priorities shown in the risk assessment.

Corporations often struggle to put into practice the requirements of a risk assessment. In many cases, the chief compliance officer or general counsel prioritizes risks intuitively based on his or her familiarity with the corporation's business and past criminal conduct. While this might result in an accurate assessment, it may not stand up to scrutiny as full compliance with the directive of the Guidelines to conduct a periodic risk assessment.

A method that has been effective for many organizations is to conduct a structured risk assessment process. First, appropriate individuals, such as members of the compliance department, the general counsel's office or senior management, would brainstorm and create a list of all possible risks of criminal conduct that might apply to the organization based upon the nature of the business and the types of transactions in which it engages. This

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Chair's Report...

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mittee continues work on its revised Entrepreneur's Almanac. The Corporate Laws Subcommittee, Chaired by Topper Webb, has been focused on several bills that have been approved by the Section Council and are currently being proposed to the General Assembly. The Unincorporated Associations Subcommittee is considering revisions to the LLC Act that it expects to propose for the 2009 legislative session. Our liaison to the ABA Section of Business Laws Committee on Legal Opinions, Sharon Kroupa, presented the Statement on the Role of Customary Practice in the Preparation and Understanding of Third-Party Legal Opinions to the Section council and received its support to add the Section to the list of organizations that supported that Statement. The Section Council also recently resurrected the Municipal Securities Subcommittee under the leadership of Bill Henn. Anyone with an interest in municipal securities and bond offerings is encouraged to contact Bill.

We encourage each of you to consider getting involved in one of these projects or in any of our subcommittees. A complete listing of subcommittees is included at the end of this newsletter. Please contact our subcommittee chairs directly and they will be happy to assist you in getting added to a subcommittee roster and getting you involved in substantive subcommittee work.

We look forward to the Section having a highly productive spring.

Regards,

Eric G. Orlinsky

Businesses Must Comply With New Data Protection Law, Starting January 1

By Michael W. Briggs

Gordon, Feinblatt, Rothman, Hoffberger & Hollander, LLC

Businesses that have personal information of individuals who live in Maryland must adopt enhanced security practices and procedures by January 1, 2008. The new Maryland Personal Information Protection Act (“Act”), to be codified at Md. Com. Law II §§ 14-3501-3508, imposes information security, document disposal and data breach protection requirements on all businesses in Maryland. Businesses also must protect against unauthorized access or use of personal information when destroying records. A violation of the Act is an unfair or deceptive trade practice under the Maryland Consumer Protection Act, which authorizes private actions and hefty penalties. To protect against liability, businesses must adopt a written information security and data breach policy. Experience shows that security breaches happen, and if a business has not adopted a written policy or does not follow its own policy, losses and potential liability are probable.

The Act applies to every business in Maryland, including law firms, and covers both customer and employee records. Banks and their affiliates may choose to comply with federal law in the alternative. “Personal information” means an individual’s first name or first initial and last name in combination with one or more of the following data elements, when the name or the data elements are not encrypted, redacted or otherwise protected by another method that makes the information unreadable or unusable: Social Security number; driver’s license number; individual taxpayer identification number; or a financial account number, including a credit or debit card number, that in combination with any required security code, access code or password, would permit unauthorized access to an individual’s financial account.

To protect against unauthorized access, all Maryland businesses need to implement and maintain reasonable security procedures to protect their customers’, clients’ and employees’ personal information. When destroying records that contain personal information, a business needs to take reasonable steps to insure that, in doing so, the information does not fall into the hands of fraudsters.

Under the Act, a breach means the unauthorized acquisition of computerized data that compromises the security, confidentiality, or integrity of the personal information maintained by the business. If someone does gain unauthorized

access to personal information maintained by your client, company or firm, the client or you will need to conduct a prompt, good faith investigation to determine the likelihood that the personal information has been or will be misused, i.e., determine the risk of harm to the individuals whose personal information was acquired. If you conclude that misuse has occurred or is likely to, you must notify the affected Maryland residents as soon as possible. Notice may be delayed if requested to do so by law enforcement, but must be given as soon as law enforcement indicates it will not impede an investigation.

Notice may be delivered in three ways: by mail, by e-mail if the individual has expressly consented to receive electronic notices or the business operates primarily online, or by telephone. A substitute notice option, comprised of e-mail, web posting and use of statewide media, is available if the estimated cost of providing the notices will exceed \$100,000 or more than 175,000 Maryland residents are affected. Before the notices can be sent, the affected business must first notify the Maryland Attorney General.

MICPEL EVENTS

International Commercial Transactions
Thursday, February 28, 2008

The 24th Annual Advanced Bankruptcy
Institute
Wednesday, March 12, 2008

Small Business
Institute and Basic Commercial
Drafting
*Wednesday, March 19,
2008*

Basic Commercial
Drafting
Thursday, April 3, 2008



Court of Appeals to Decide Fate of “No Closing Cost” Home Equity Loans

By Catherine Brennan
Hudson Cook LLP

Maryland mortgage lenders anxiously await the Court of Appeals’ ruling in *Bednar, et al v. Provident Bank of Maryland*, (Baltimore City Circuit Court Sep. 13, 2006, Case No. 24-C-05-011136), cert. granted, Case No. 142, Sept. Term 2006, in which the high court will decide whether a mortgage lender may impose “closing costs” on a borrower who fully prepays a second mortgage loan at the time of prepayment.

Andrew Bednar obtained a “no closing cost” closed-end second mortgage from Provident in 2003. The mortgage required Bednar to keep the mortgage open for three years; otherwise, he would have to repay the third-party closing costs Provident paid at closing. Bednar paid off the loan short of the three-year time frame, and Provident sought to recoup \$681 in closing costs. Bednar sued Provident, arguing that the attempt to recoup the closing costs operated as a prepayment penalty, which Maryland law prohibits in connection with junior lien mortgages. Bednar also claimed that Provident violated the Maryland Consumer Protection Act, Md. Com. Law II §§ 12-1001 et. seq., because the bank failed to disclose that Maryland law prohibits prepayment penalties on junior lien loans. Bednar sought class certification for his lawsuit, but the Baltimore City Circuit Court granted the bank’s motion for summary judgment. Prior to this litigation, the Maryland Division of Financial Regulation had issued three letters in which the Division concluded that, for loans like Bednar’s governed by the Credit Grantor Closed End Credit Provisions, Md. Com. Law II §§ 12-1001 et. seq., lenders may defer closing costs and “recapture” them if the borrower pays off the loan within a predetermined time

period. According to the Department, such recoupment does not constitute a prepayment penalty.

Bednar appealed, and the Court of Appeals granted certiorari on March 14, 2007 because of the importance of the outcome to the mortgage industry. The high court heard arguments in *Bednar* in early June 2007. During the argument, the court seemed to agree with Bednar that Provident’s attempt to recapture the closing costs operated as a prepayment penalty. Maryland law permits a consumer borrower to prepay a loan in full at any time. Md. Com. Law II § 12-1009(a). Further, in connection with any prepayment of any loan, the lender cannot impose “any prepayment charge.” Md. Com. Law II § 12-1009(e). The court focused on the fact that the imposition of the closing costs at the time of the prepayment operated as an unlawful prepayment charge – even though the lender could clearly impose the fees had it done so at closing. Maryland permits the imposition of closing costs in connection with the type of loan Bednar obtained if the costs represent actual verifiable expenses paid to third parties and are limited to: (1) attorneys fees for services rendered in connection with the preparation, closing or disbursement of the loan; (2) any expense, tax or charge paid to a governmental agency; title examination, appraisal, or other costs necessary or appropriate to the loan’s security; and (3) premiums for voluntary credit insurance and required property, title or credit loss insurance. Md. Com. Law II § 12-1005(d). Although the *Bednar* case involves a closed-end loan, the ruling will also impact lenders offering home equity lines of credit because similar provisions apply to such lines of credit.

June 11-June 14, 2008

MSBA ANNUAL MEETING OCEAN CITY, MARYLAND



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SEA. YOU. THERE.

Boat Lifts and Riparian Rights: A Cautionary Tale

*By J. Richard Ronay, Esquire
Lochner and Schwenk, LLC*

Shoreline development in recent times has meant lucrative business for residential and marina condominium developers. Clearly, the value in such projects is largely tied to the promise of water view and water access. It is crucial that developers understand how riparian rights are to be parsed in such high density developments. Recent appellate decisions in Maryland have reinforced the concept that riparian rights are to be viewed just as any other property right, subject to transfer and use by their owners in accordance with the terms of the grant conveying them. (See *Gunby v. Olde Severna Park Improvement Ass'n, Inc.*, 174 Md. App. 189, 921 A.2d 292 (2007), *Olde Severna Park Improvement Ass'n, Inc. v. Gunby*, 402 Md 317 (December 3, 2007). Thorough consideration must be undertaken by developers and their lawyers in the planning stages, to be sure that all parties have a clear understanding of the apportionment of the rights being transferred.

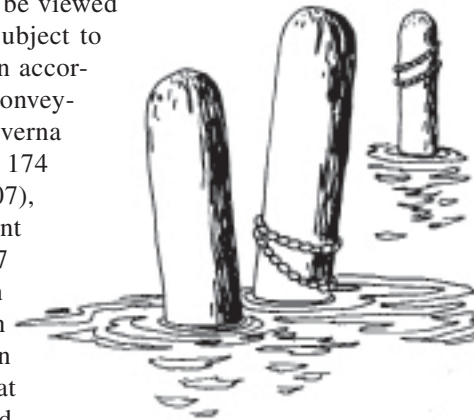
For perspective, we should bear in mind that riparian rights are incorporeal property interests that derive from ownership of land adjoining navigable waters and have to do with the property owner's right to use the interface between land and water in various ways. The term represents a collection of uses including the right of access to the navigable part of the waterway and the right to construct a wharf, pier or other means of securing a boat to the shore, sometimes referred to as the right to wharf out. In a condominium, all unit owners might collectively share in the riparian rights, subject to the terms and conditions set up by the developer in the declaration.

A matter that recently came to our attention illustrates in a small way potential riparian rights issues which may arise in waterfront condominium development.

Our client wanted to install a boat lift in his condo slip but was informed by the board of directors that boat lifts were not permitted. The board no doubt feared establishment of a precedent – if one lift were permitted, others would surely follow and the harmonious appearance of the marina would be compromised. By the time we became

involved, the dispute had polarized members of the board and the unit owners.

The Condominium Declaration provided a mechanism for granting each unit owner the exclusive right to use of a particular slip for the “mooring” of a recreational watercraft, “as a riparian right”. Each deed contained an assignment of the grantee’s particular slip.



The board asserted in our case that boat lifts were neither specifically allowed by the Declaration nor defined as a mooring under maritime law. When hard pressed, they were forced to concede that the term mooring was generally defined as a place where a vessel is made secure or the means by which it is made secure, a definition which surely described a boat lift.

The objecting board members were left conceding the ambiguity of the Declaration language which, in turn, left them with little solid foundation upon which to rest their objection. Had the language of the Declaration been more carefully crafted, the conflict could likely have been avoided.

Drafters wishing to avoid confusion should consider an approach that reserves the riparian rights to the condominium association and provides a system of transferable limited licenses for the slips. If riparian rights are to be specifically conveyed with each unit, the declaration and each conveyance, by reference, should set out clear limitations on those rights which the board could then enforce.

As waterfront and shoreline becomes ever more developed, conflicts over riparian rights are sure to become more focused and contentious. We should attempt to anticipate the potential conflicts and limit them before they arise rather than become embroiled in dispute and litigation after the fact.

Third World Government Contracting: Collecting from A Foreign Sovereign

By Richard Sternberg

In the world as it exists after the Cold War, there has been a significant expansion in international trade opportunities vending to emerging and third world nations. Without the competition between superpowers to spend foreign aid money seeking alliances with the third world, more nations have entered the commercial markets to purchase goods and services, including everything from air travel goods, to construction, to modern technology, to oil and mining supplies and servicing, food, medical services and supplies, and other goods and services previously obtained by foreign aid grants. Many of these countries possess significant wealth to match their significant needs. There are opportunities available in this form of government contracting that modern competitors in the U.S., E.C., and Pacific Rim cannot afford to ignore.

There is significant risk in this market, however. Market risks are unlike the normal business risks of international transactions, for the purchasers are often governments or government agencies. Without proper planning, the sovereign buyer will be immune from lawsuit. The devices of the international letter of credit or international arbitration are often inconvenient or unacceptable to the government purchasing agent. As a result, the merchant faces a risk that the buyer will refuse or substantially delay payment, unilaterally change the terms of the agreement, or find grounds to dispute the transaction knowing that there is no effective mechanism for resolving the dispute. Business people who are familiar with government contracting in the West are aware that Western governments can play these same games, which can ultimately drive a supplier out of business, but without a tolerable mechanism for enforcement of contracts, trade in this potentially profitable market becomes too risky. A competitor which can reasonably secure its payment can avoid charging a substantial risk premium and can offer more competitive pricing.

In the shadow of the Cold War, most of the Third World recognizes the likely significance of the United States in world diplomacy and have created international banking and financial arrangements in the United States to complement and facilitate their diplomatic efforts. Such international banking arrangements within the U.S. are essential in the modern world, and emerging nations cannot afford to abandon them, even when the United States openly flaunts its use of subpoenas and electronic intelligence to trace financial transactions through the United States. Handled correctly, this potential source for paying damages — as well as the foreign sovereign's desire not to get bad publicity in

the local newspapers in Washington — makes it tactically convenient to find some basis for adjudicating disputes between merchants and sovereigns within the United States. That source is the U.S. Foreign Sovereign Immunities Act (the "FSIA"), 28 U.S.C. §§1602 et seq., and a merchant who plans its contract in advance can obtain jurisdiction in the U.S., thereby massively improving its ability to collect on its contracts both by litigation and by pre-litigation pressure to comply with the contract.

There are some additional start-up costs involved in entering this trade. The FSIA cannot be used to protect a foreign company from non-payment in a foreign contract, but through the magical fiction that corporations are citizens wherever they are formed, the FSIA can protect the wholly-owned American corporate subsidiary of that same foreign company if its duties include managing the contract.¹ The FSIA strictly limits jurisdiction to only four categories of lawsuit, but a foreign sovereign can consent to jurisdiction with the most innocuous of language placed in a contract, or, even, by contracting to make payments in the United States. 28 U.S.C. §1605.

It is difficult to reveal the many techniques to be considered in foreign government contracting in a brief article, but merchant companies considering trade with foreign sovereigns ought to review with their counsel the formation of an American subsidiary in the Washington metropolitan area to manage the government contract in order to maximize its ability to enforce and collect on the contract. Including language in the contract that places the contract under U.S. law and submits the buyer to U.S. jurisdiction in a manner designed to work within the FSIA subtly can become an enormous competitive benefit.

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Footnote:

¹See 28 U.S.C. §1332 (2007). This is expressly inapplicable to shippers under the Shipping Act, 46 U.S.C. §802(a), but was applied in *Phoenix Consulting v. Republic of Angola*, 216 F.3d 36 (D.C. Cir. 2000). The property in the Phoenix case was owned by, and the contracts were made with, the U.K. parent corporation. The U.S. subsidiary corporation arguably hired the agent. The Court remanded the case to the district court after concluding in the first line of the background that plaintiff was "a United States affiliate" of the alien parent corporation. Defendant argued vociferously and unsuccessfully that this made the U.S. subsidiary corporation an alien outside the jurisdiction granted by the FSIA.

Use of Keyword Triggers Can Trigger Problems for “Contextual Marketing”

By Louis J. Levy and David M. Rigsby
Leventhal, Senter and Lerman PLLC

Contextual marketing has become a linchpin of advertising strategy on the Internet. Stated simply, contextual marketing allows advertisers to generate targeted advertisements to individual computer users based on browsing habits using a variety of “search engine optimization programs” (aka “SEO” programs). One form of contextual marketing involves the generation of “sponsored links” by search engines when users type in specific “keywords.” For example, a computer user searching for information on “athletic shoes” will receive the “natural” search results, i.e., links generated by the particular algorithm used by the search engine, as well as series of “sponsored links,” i.e., links paid for by select advertisers to attract users to their particular websites. For “sponsored links,” advertisers pay search engines to generate their advertisements when users type in specific keywords. The sponsored links that appear are therefore not part of the “natural” search results.

Fair enough so far. But what happens when search engines sell advertisers keyword triggers comprised of third party trademarks such that the advertisers “sponsored links” appear close to the “natural results” that would, by definition, feature the website or websites of the owner of the trademark?

This issue forms the crux of a claim filed by American Airlines against Google in the Northern District of Texas. (*American Airlines v. Google*, No. 4-07CV-487-A (N. D. Tex., filed August 16, 2007).

This is not the first time courts have visited this issue. Indeed, beginning in 2003, American Blinds challenged Google over exactly this question, ultimately alleging that Google’s sale of certain keywords to advertisers to generate the ads of competitors infringed its trademark under the Lanham Act, among other claims. While the court granted Google’s Motion for Summary Judgment this year, it did so based on a technical trademark issue concerning the inherent protectability of the AMERICAN BLINDS mark. Significantly, the Court specifically denied Google’s motion with respect “to the extent that it is brought on the basis of an asserted absence of trademark use.” *Google, Inc. v. American Blind & Wallpaper Factory, Inc.*, 2007 U.S. Dist. Lexis 32450 at *20 (N.D. Cal. 2007). The parties eventually settled.

In a second case, insurance provider Geico also sued Google over its sale of keywords to generate sponsored links. Google’s motion to dismiss the Lanham Act claims brought by Google was denied in August 2004, *Gov’t Employees Ins. Co. v. Google*, 330 F. Supp. 2d 700 (E.D. Va. 2004), as further explained at 77 U.S.P.Q.2d 1841 (E.D. Va. 2005). The parties settled before the court had an opportunity to reach the merits on those claims.

In another frequently cited case involving so-called “adware” programs, the Second Circuit ruled that adware provider Whenu.com did not commit trademark infringement by using trademarked terms to generate pop-up advertisements appearing contemporaneously with the appearance of the plaintiff’s website. *1-800 Contacts, Inc. v. Whenu.com, Inc.*, 414 F.3d 400 (2d Cir. 2005). The facts of this case, however, differ from those raised in the Google cases in so far as it did not involve the generation of “sponsored links” in search results. Indeed, outside of the 2nd Circuit, courts have found that use of a third party’s trademark to trigger online advertisements or sponsored advertisements does constitute trademark infringement. See *800 JR Cigar, Inc. v. GoTo. Com, Inc.*, 437 F. Supp. 2d 273 (D.N.J. 2006); *Buying for the Home, LLC v. Humble Abode, LLC*, 459 F. Supp. 2d 310 (D. N.J. 2006); and *Edina Realty, Inc. v. The MLSOnline.com*, 80 U.S.P.Q.2D 1039 (D. Minn. 2006). Courts are therefore split on whether the sale of keywords comprised of trademarked terms by search engines to generate sponsored links constitutes trademark infringement and related torts.

The American Airlines case may alter the landscape. In this case, American Airlines, like Geico and American Blinds before it, alleges that Google has infringed its marks by selling keywords comprised of its marks to advertisers, which keywords then trigger sponsored links of competitors and others along side the “natural” search results. This use of its marks, the complaint alleges, is likely to confuse or deceive consumers into believing that that the sponsored links, and the services they identify, are either sponsored by, or in some other manner associated with, American Airlines. American Airlines is also seeking relief for a range of other federal claims, including contributory and vicarious trademark infringement, trademark dilution, false representation, and related state claims, including tortious interference with contract.

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Use of Keyword Triggers . . .

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In response to this complaint, Google filed a Motion to Dismiss on grounds that American Airlines had failed to state a claim. In particular, Google argued that its use of trademarked terms as keywords failed to constitute “trademark use,” as required under law for a trademark infringement claim to proceed. The court rejected Google’s motion in full in a two paragraph order issued on October 24, 2007. American Airlines, No. 4-07CV-487-A (Oct. 24, 2007) (order denying motion to dismiss). Google filed an Answer on November 7. *Id.* This case will now go forward on its merits, provided the parties do not settle.

The outcome of this case has major implications, not only for Google and other search engines, but for advertisers as well. In particular, a victory for American Airlines will buttress those arguing that use of trademarks as keywords to generate sponsored advertisements and other types of online advertising constitutes trademark infringement. Although the courts are clearly divided on this issue, as noted above, a decision of this nature, which involves major corporate players, is sure to reverberate at all levels of commerce. Search engines and other companies that provide contextual marketing services will have to reconsider the extent to which they use third party trademarks as keywords given the potential liability. Advertisers will similarly have to reconsider the keyword advertising triggers they purchase from Google and other search engines. Indeed, advertisers have already been held liable for the purchasing keyword advertising triggers comprised of a competitor’s trademark. See *Edina Realty, supra.* (defendant’s summary judgment motion on trademark infringement claims denied where defendant purchased and used keywords comprised of plaintiff’s mark to generate advertisements in Internet search results, *inter alia*).

It is also important to note that a decision favoring American Airlines would be generally consistent with practice in Europe, where the use of trademarks as keywords to trigger various forms of online advertisements has already been found to constitute trademark infringement in several cases. See, e.g., *Societe Viaticum et Society Luteciel v. Google France*, Tribunal de grande instance (T.G.I.) [ordinary court of original jurisdiction], Nanterre, October 13, 2003, affirmed, Cour de appel, Versailles (Versailles Court of Appeal), Chamber 12, Section 1, March 10, 2005, cited in *Links and Law, Adwords Lawsuits in France – Trademarks as Keywords Illegal*, <http://www.linksandlaw.com/adwords-google-keyword-lawsuit-France.htm> (last visited December 10, 2007).

Even if this case settles before a decision is reached, the unsettled nature of U.S. law in this area - and the clear position of European courts that favor the rights of trademark holders on this question - creates continued risks for those who advertise online using contextual marketing programs or search engine programs such as Google’s “AdWords.” As companies develop their online marketing strategies, they should therefore take pains to understand the precise nature of the online advertising and search engine optimization programs they use to be certain that third party trademarks are not utilized to trigger sponsored links or other forms of online advertising such as pop-ups and banner ads. By so doing, they can minimize the risks of liability that can arise from such practices.

Conducting a Risk Assessment...

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list would then be organized according to logical groupings – e.g., types of antitrust violations, Foreign Corrupt Practices Act violations and securities laws violations.

Second, appropriate officers and employees would assess the list of risks and assign a numerical ranking to each item in this list, both for likelihood of occurrence and severity of consequences. This could be done through group meetings, individual interviews or written surveys. Group meetings have the advantage of allowing discussion among the individuals and clarification offered by legal counsel. It is crucial that the group meetings or interviews are carefully planned and conducted by one or more individuals familiar with risk assessment techniques, the Guidelines and criminal conduct applicable to corporations. It can also be useful to seek guidance from the company’s auditors and outside counsel familiar with creating and evaluating compliance programs.

The final step is to calculate the risk for each listed item. An accepted method for quantifying risk is to multiply the assigned value for the likelihood of the offense by the assigned value for the consequences of such an offense. See, e.g., U.S. Department of Justice, Office of Justice Programs, National Institute of Justice, *A Method to Assess the Vulnerability of U.S. Chemical Facilities* (November 2002), available at <http://www.ojp.usdoj.gov/nij/pubs-sum/195171.htm>. This simple formula will yield a numerical ranking of risks that will serve as a basis for action steps designed to address the highest ranking risks. Once the risk assessment is completed, it can then be incorporated into the company’s compliance program, to be reviewed periodically by management and the general counsel.

Revised FTC Franchise Rule Alters the Landscape of Franchise Sales Disclosure Obligations

By David L. Cahn, Esq.
Franchise and Business Law Group

On January 23, 2007, the Federal Trade Commission adopted a revised trade regulation entitled “Disclosure Requirements and Prohibitions Concerning Franchising,” 16 CFR Part 436, as amended, 72 Federal Register 15444 (March 30, 2007). The revised “Franchise Rule” went into effect on a voluntary basis on July 1, 2007, and compliance becomes mandatory on July 1, 2008. The disclosure requirements in the revised Franchise Rule are based upon the Uniform Franchise Offering Circular (“UFOC”) guidelines, issued by the North American Securities Administrators Association (“NASAA”) in 1993,¹ that had been the standard for franchise disclosure documents. The changes to the UFOC made by the revised Franchise Rule are “evolutionary, not revolutionary,” but nevertheless practitioners will have to make some adjustments to issue a Franchise Disclosure Document (or “FDD,” the new acronym of art) that complies with the revised Franchise Rule.

The most noteworthy features of the revised Franchise Rule are as follows:

1. All franchisors may now use electronic means to provide their disclosure documents to prospective franchisees. (This change took effect on July 1, 2007.) While electronic methods arguably were permitted prior to promulgation of the revised Franchise Rule, due to the Electronic Signatures in Global and National Commerce Act (“E-SIGN”), 15 U.S.C. 7001, the revised Franchise Rule confirms this and specifies acceptable methods and procedures for doing so.

2. More extensive disclosures concerning a franchisor’s parent company may be required. Of particular significant, the Franchisor must disclose: (a) a parent company bankruptcy during the prior 10 years; (b) if the parent “induces franchise sales by promising to back the franchisor financially or otherwise guarantees the franchisor’s performance”; (c) litigation disclosures required by a franchisor, principally administrative, criminal or civil actions alleging “a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices, or comparable allegations”; (d) for “any parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor’s obligation”, audited financial statements for the prior three fiscal years.

3. Franchisors do not have to provide information about “franchise brokers” within the body of the disclosure docu-

ment, which will eliminate the often voluminous rosters of “franchise consultants” from companies such as “Franchise Choice” that have been exhibits in the UFOC. However, if a franchise broker plays a substantial role in the sale of the franchise, he or she must be named in the acknowledgment of receipt of the FDD.

4. Franchisors will be required to identify all litigation with franchisees during the prior fiscal year, whether initiated by the franchisor or the franchisee, except for claims by the franchisor demanding indemnification for tort liability. The disclosure of franchisor-initiated actions is permitted in a summary fashion; however, a complete disclosure is required should a franchisee assert counterclaims or initiate an action.

5. Disclosures regarding “earnings claims” (now called Financial Performance Representations, or “FPR”) have changed under the new Franchise Rule. First, the franchisor must explain in Item 19 of the FDD that it is permitted, but not required, to provide a FPR. Second, to encourage more franchisors to provide a FPR, the revised Franchise Rule permits franchisors to base the representation on a subset of franchisor or company-owned operations; the subset must, however, consist of stores that have common characteristics other than being the best performers!

6. In Item 20 of the FDD, the franchisor must disclose: (a) whether it has entered into confidentiality agreements or clauses with current or former franchisees regarding the franchise relationship (except for non-disclosure of a franchisor’s trade secrets or proprietary information, such as recipes); and (b) the existence of and contact information for an independent association of franchisees, if that association is an entity organized under a state’s law and requests inclusion in the FDD.

7. A new exemption from providing the FDD exists for franchises in which the franchisee’s initial investment is in excess of \$1,000,000, not including the costs to acquire unimproved land. The exemption is applicable if the investment of more than \$1,000,000 will be made by an individual or a married couple. Sales to franchisee entities that have a certain amount of net worth and years of experience as

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Updated December 6, 2007

Revised FTC . . .

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a franchisee (so-called “Sophisticated Franchisees”) are exempt by a different provision of the Franchise Rule.

State Franchise Registration and Disclosure

The regulators of the 13 states that require registration by franchisors before the offer or sale of a franchise have, at least on a temporary basis, adopted the FDD as a replacement for the UFOC, with the only additional requirement that the franchisor disclose certain “risk factors” on separate “state cover page.” Therefore, it appears that, beginning on July 1, 2008, there will be a virtually uniform system of franchise disclosure in all 50 states.

However, the substantive provisions of state franchise registration and

disclosure laws remain in force, including prohibitions on requiring waivers of compliance with the statute and on requiring the franchisee to litigate outside its home state. In addition, the requirements of registration are unaffected, and several registration states still may require a new or financially troubled franchisor to escrow or defer receipt of initial payments by franchisees until the franchisor has performed its pre-opening obligations and the franchise is open for business.

Finally, one notable difference between the revised Franchise Rule and the Maryland Registration and Disclosure Law is that a franchisor must provide the FDD to a Maryland resident, or someone planning to open the franchise in Maryland, at the ear-

lier of: (a) the first in-person meeting to discuss the franchise opportunity; or (b) 10 business days before selling the franchise. By contrast, the revised Franchise Rule just requires disclosure not later than 14 calendar days before a prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

Footnotes:

¹The Guidelines for preparing a UFOC under the prior rules can be found at <http://www.nasaa.org/content/Files/Uniform-FranchiseOfferingCircular.doc>

²The current requirements imposed by registration states, including the full text of the guidelines for preparing a FDD, can be found on NASAA’s website at http://www.nasaa.org/content/Files/Franchise_Interim_State_Guidelines.pdf

Committee Reports

Emerging Companies Committee

The MSBA Emerging Companies Committee will be meeting on March 12, 2008 at the offices of Saul Ewing LLP. The Committee will be continuing its work revising and updating "The Entrepreneur's Almanac," last published 11 years ago as an informational "tool kit" for entrepreneurs and other start-up company owners and advisors. Please RSVP to James Harris (charris@saul.com or 410-332-8763) if you would like to attend.

If anyone is interested in joining this committee or offering any assistance, please contact either Charles J. Morton, Jr. (cjmorton@venable.com or 410-244-7716) or James Harris at the number above for details.

International Law Committee

MICPEL and the International Law Committee will present International Business Transactions on Thursday February 28, 2008, 8:45 a.m. – 3:00 p.m. at the Ecker Business Training Center, 6751 Columbia Gateway Drive, Columbia. Please contact MICPEL at 410-659-6730.



Maryland businesses export more than \$7 Billion a year and nearly 500 foreign companies have offices in our state. This presentation will review the major aspects of and legal issues involved in international commercial transactions, incorporating the latest legal developments both in the US and foreign law. We have assembled a distinguished faculty of 10 individuals and expect the content to be very informative.

Municipal Securities Committee

We are please to announce the re-formation of Municipal Securities Committee. Anyone interested in joining this committee should contact Bill Henn (William.henn@mshllp.com or (410) 843-3520).