

LEGAL ISSUES OF INTERNET MARKETING

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ABSTRACT

The explosion of marketing knowledge over the past two decades has made it increasing more difficult for marketing educators to remain current in their field. This is particularly true in areas such as Internet marketing where technology is rapidly transforming the practice of marketing. However, the legal aspects surrounding its use have not been clearly defined. The purpose of this paper is to summarize the emerging legal issues related to the use of the Internet.

INTRODUCTION

The Internet has become a medium of great interest for marketers since 1993 when the graphical portion of the Internet known as the World Wide Web was developed. The number of participants on "The Web" has been doubling every 53 days (Wehling 1996). Accordingly, industries which hardly considered the Internet a few short years ago are rampant with discussion and activity surrounding "Web presence" as an integral portion of marketing communications programs. Furthering the interest in this medium is the fact that it serves a global clientele. While most Internet service providers, content providers, and users are still North American or Western European, the accesses from Asia and smaller developing regions is growing rapidly.

Many issues arise for marketers as the stream of participants approaches a population surpassing that of many industrialized countries. One of the particularly interesting areas is that of the legal environment. Many legal issues relevant to the Internet are being handled as popularity dictates. A good example is the attempted censorship of pornography transmitted via the Internet in ways that are accessible to children. This issue was addressed through a provision of the 1996 Telecommunications Reform Act. However, it was later deemed unconstitutional by the federal courts. The purpose of this paper to summarize the legal issues related to marketing via the Internet. Due to paper length constraints only a broad discussion of these issues is possible.

LEGAL LITERATURE RELATED TO INTERNET MARKETING

Much of the literature addressing the legal aspects of the Internet has focused on consumer privacy issues, fraud, and misleading advertising (Yang 1996). However, there exists a host of other issues. There are potential antitrust problems if a marketing effort is conducted while having an exclusive dealer network in place. The three day cooling off requirement for telephone sales also may apply to sales made via the Internet. There are potential copyright issues dealing with printed materials and music. Federal, state, local, and international laws apply in specific industries such as gaming, the distribution of beer, wine, and distilled spirits (Ferguson and Samuelson 1996), and financial services (Vogelstein 1996). Lastly, common legal issues involved in store retailing, such as bait and switch, sales and other taxes, and liability may apply to Internet marketing. These issues are summarized below in a form that marketing educators can use to supplement their existing course material on Internet marketing.

Privacy

This issue has been addressed extensively as consumers are concerned about the privacy of information pertaining to them and their families. Social security numbers, driver's licenses, credit reports, financial status, etc. are all considered personal and widespread distribution is not desired.

Regarding privacy self regulation by Internet marketers has been both aggressive and effective. In June 1996, The Direct Marketing Association announced a plan for extended self regulation to include Internet based commerce as well as other mediums in direct marketing (*Business Wire* 1996a).

Fraud & Misleading Advertising

Another major area that has been addressed is the area of fraud and misleading advertising. The Federal Trade Commission (FTC) has been active in the regulation of these practices on the Internet. The FTC proposed the Telemarketing Sales Rule in April, 1996 which covers sales made by mail, telephone, computer, and fax machine. In a statement released June, 1996, the FTC noted that "the same laws that

protect you when you shop by mail or phone apply when shopping online." (Federal Trade Commission 1996b). Likewise, the Fair Credit Billing Act also applies if a consumer uses a credit card to make an on-line purchase (Federal Trade Commission 1996b). Statements with this kind of clarity are easy for marketers and consumers to understand; however, not all statements are quite as clear in applicability. For example, the FTC released a rule in 1993 (prior to the onslaught of Internet marketing) which required marketers soliciting pay-per-call services to disclose certain information in any print, radio, and television advertisements (Federal Trade Commission 1993). It is unclear whether or not this rule would apply to Internet marketers. One could generalize the above statement about laws applying to marketing via mail applying to shopping on-line to conclude that laws applying to print advertising (such as direct mail) would apply to on-line advertising, but this would be an as-of-yet ambiguous conclusion.

Internet industry leaders encouraged the FTC to allow the industry to regulate itself to achieve the desired goals of Congress when it authorized the rule. The Electronic Messaging Association President vowed to work with the FTC to avoid what he called a "chilling effect" on digital commerce (*Business Wire* 1995). Since then, the FTC has largely allowed self regulation except in instances where self-regulation has failed to accomplish a stable environment. For example, the recent arrest involving Fortuna Alliance in Redmond, Washington which was using a fraudulent Internet pyramid scam to funnel money to a Caribbean account (Bunker 1996).

Another form of misleading advertising via the Internet "newsgroups" or "chat-rooms" is the "posting" of false endorsements for products by employees or affiliates of the seller. On the Internet, it is very easy to disguise one's identity to create a false air of credibility. The FTC is beginning to investigate everything from these false endorsements to false miracle cures which have made their way to the Internet. (Yang 1996).

Three Day Cooling Off Period

In November, 1992, the FTC released "The Cooling-Off Rule" which protected consumers who made a purchase from the consumer's home or from a location that is not the seller's permanent location (Federal Trade Commission 1992). This rule includes telephone and Internet sales. There are a number of exceptions to this 1992 rule. Most notably, "The Cooling-Off Rule does not cover sales

that: ...are made entirely by mail or telephone; ...involve real estate, insurance, or securities." Therefore, if a business is exclusively a mail, telephone, or Internet retailer, the consumer is not protected by the rule. Also, under this rule, neither insurance or securities are covered.

Copyright Infringement

Some laws like those designed to protect copyrighted material extend to the Internet. However, copyright is one of the most difficult areas of Internet law in practice because the violations are so rampant. The free spirited knowledge sharing origins of the Internet have created an atmosphere where users seem to feel that all material on the Internet is public domain (*Business Wire* 1996b). Protection of intellectual capital through successful copyright enforcement is one of the key issues on the frontier of Internet law. Many practitioners have come to the conclusion that the Uniform Commercial Code will need to be modified to better accommodate electronic commerce (Krohm 1996). The industry is trying to step in where it feels it may better solve the problem through technical strategies rather than focusing on laws.

Regulated Industries

The Internet has been used for direct marketing in many industries in which applicability of laws is often quite difficult to surmise. This difficulty extends to new heights in the industries which are already regulated. From the brokerage standpoint, the direct marketing of securities is a good example because of the legal restrictions the industry has on written communication with clients. If those requirements are applied to electronic mail, the Internet would likely remain a passive element of the industry—telephone communication would still be the preferred medium of communication (Lux 1996).

In a specific extension of existing laws to the Internet, the SEC handed down its view of the Internet as a communication tool for securities marketers in a series of statements that did not disfavor the use of the Internet. The SEC stated that the responsible parties can be ensured that investors have access to and can retain paper copies of all SEC required documentation (Grand and Gary 1996).

The trend has begun in the direct marketing of stocks via the Internet to investors by the companies themselves, bypassing brokers. The SEC has also been instructive with these firms to assist them in

navigating around rules and legislation. As an example, Spring Street Brewing Co. went public with its Internet based IPO in March, 1996 (Taylor 1996). Although the SEC has cleared the way for many stock marketers and investors to use the Internet, the U.S. Commodity Futures Trading Commission (CFTC) has not approved trading via the Internet. However, futures traders can send monthly and quarterly statements via e-mail to clients who give their consent (Doggett 1996).

The insurance industry is very controlled via licenses which dictate regions in which the insurer is permitted to operate. With conventional techniques (mailings, agents, telemarketing, etc.) this is fairly straightforward. However, the Internet is not regionally divided and the entire world is accessible to an insurer just as easily as those potential customers very close in proximity. In fact, 20% of Zurich Life's policy queries on its Swiss Web are from the United States, possibly adding substantial profitability. The temptation seldom proves fruitful as regulators have routinely prevailed in court actions against unauthorized insurers extending their bounds (Krohm 1996).

Like securities and insurance, gaming and the distribution of wine, beer, and spirits are regulated industries. Gambling is illegal in most U.S. states and is one of the best examples of how jurisdiction and enforcement can be complicated when transactions are conducted via the Internet. Most gaming "hosts" take advantage of the international, boundary-less nature of the Internet and operate in locations where gambling is condoned. For example, the Caribbean island of Antigua makes tax revenues from the gaming companies and does not extradite people for this activity to the U.S. Also, the country of Liechtenstein invites international participants in its national lottery without concern for the laws of the participants native land (Krohm 1996). Unable to combat these foreign governments, the state regulators are powerless in the regulation of international gaming, even when U.S. residents do so in their home (Orwell 1996).

The Internet based distribution of wine, beer, and distilled spirits is more effectively regulated because a physical product is exchanged and most participants (sellers and buyers) are located domestically. Generally, the sellers to be affected are California's small, premium vintners who cannot crack large consolidated distribution lists. These small wineries Internet and mail order sales aggregate to over \$1 billion a year in the U.S. This does not include the "beer of the month" clubs who

are much smaller, but are ostensibly the focus of regulation (Kinnaid 1996).

The motivation for regulating this aspect of the industry is controversial. It has elements of channel conflict (distribution who are missing out on business are leveraging power in government), tax revenue (mail order shipments are untaxed), and consumer protection (preventing children from purchasing alcohol from clubs who cannot confirm ages) (Ferguson 1996).

The most publicized regulatory effort comes from the state of Kentucky which has made any kind of mail-order (including Internet based) shipping of alcoholic beverages into the state a felony. Sensing the regulation was an act of political leveraging rather than genuine consumer concern, many California wineries have boycotted the state of Kentucky. The largest, Kendall-Jackson, was lead by its owner to support the smaller vineyards which need the mail order sales to sustain their businesses (Goetz 1996).

Product Liability

Marketers using the Internet potentially face several sources of exposure to product liability theories including breach of warranty, and negligence and strict liability tort. These liability theories apply when the product user is injured by a product defect. There are several aspects in the marketing of a product that can create a product defect including misleading advertising copy, and inadequate labels and product warnings. These issues may apply because when it comes to using the Internet as a method of distribution, it is a challenge to control who has access to the product and how it is marketed.

Negligence and strict liability tort should be a major concern for those who use the Internet to market their products. Negligence can arise if essential label or warning information is omitted or poorly communicated through the Internet. For example, warnings of side effects must be disclosed in the marketing of pharmaceuticals. If such warnings are not included, manufacturers and distributors may be liable for consumer injuries caused by defective products. To limit their liability exposure manufacturers must foresee how distributors using the Internet might miscommunicate product attributes to the target audience.

Consumer product warranties are regulated by the Magnuson-Moss Warranty Act of 1975. Provisions of this Act require disclosure of the terms of an expressed (written) warranty prior to the product's

purchase. Breach of warranty may be avoided by providing such disclosure in an Internet sales appeal together with any specific exclusions and disclaimers.

Antitrust

The federal antitrust acts potentially could apply to situations involving direct marketing via the Internet. Potential pitfalls exist in both horizontal and vertical price and nonprice restraints. Horizontal restraints involve efforts by distributors to fix prices. To prove horizontal price fixing one must first prove there was an agreement to fix prices. An agreement could be inferred from identical offers by different competitors to sell the same product at the same price over the Internet. Second, anticompetitive conduct must result from the agreement. Specifically, prices must become fixed due to the use of the Internet. However, the fact that prices are the same does not mean sellers "colluded" to set them.

The use of vertical price and nonprice restraints is where there are potentially the greatest problems with the antitrust acts. Vertical price restraints involving location clauses, exclusive dealerships and franchises potentially may be affected (Ostrom, Jackson and Kelley 1986). The Internet makes it easy for a distributor to compete in the territory of another or offer additional brands not covered by an exclusive dealership agreement. Manufacturers that take steps to terminate such distributors and franchisees are subject to a claim of trying to implement a resale price maintenance program.

CONCLUSION

The FTC and other government entities have come out with statements in support of self-regulation within the industry. The FTC has expressly given the industry six month time frames in which aspects of regulation will be considered, such as privacy control (Harrison 1996). In the meantime, the government is not ignoring nor using a wholly "hands off" approach. President Clinton appointed a FTC member whose mission is "to become the first U.S. Cyber-Marshall" and she doubts self regulation will provide all the answers for adequate consumer protection (Yang 1996). A fair interpretation of that fact is that the FTC will continue to seek ways to regulate Internet commerce in areas that are not being sufficiently controlled through industry organizations such as the Direct Marketing Association. Also, the review of such self regulatory efforts is likely to be often and thorough.

One can reasonably conclude that Internet marketing bears a close tie in nature to direct marketing via mail and telephone. As the Internet develops more capabilities of telephony, this argument will get stronger; however, with this enhanced functionality will come discussion as to whether or not telecommunications regulations which apply to other long-distance service providers. This argument is only now developing (Buckman 1996).

Also, as teleconferencing capabilities increase and as buyers and sellers come together in a more face-to-face environment, personal selling laws may come into effect to help protect consumers. At that point, the virtual store front presented through Web pages may be considered equal to a conventional store front, eliminating the protection of telecommunication rules such as the potential for a three day cooling-off period.

In the long run, the ability of marketers to use the Internet successfully as a direct marketing tool seems to be largely a function of their behavior. The industry has demonstrated capable strength in self regulation of conventional direct marketing efforts; but, the relationship was created overnight. As the Internet grows in use as a commercial device, the government will increasingly monitor it for abuses of consumers.

The types of regulation we can expect down the road will likely mirror that of the medium it resembles. For example, the Internet may develop as a mass media broadcasting tool for video on demand and other television like services. In that case, the government may chose to regulate the content of direct marketing Internet sites which are intended for child audiences the way it regulates television commercial content during children's programming via the . Likewise, we may see a ban of tobacco advertisements from web sites for similar reasons.

As an interim stage, many radio stations are beginning to provide listeners with real-time ability to listen to their radio stations via Internet connections. The government does not currently regulate this service as it does the licensed airwaves, but there is potential for that down the road.

REFERENCES

Available upon request.