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Aspects of European Regulation of e-commerce

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I What is e-commerce?

Electronic commerce has been defined as ‘any form of business transaction in which the parties interact electronically rather than by physical exchanges or direct physical contact’.¹ The world of electronic commerce revolves on buying and selling goods and services and carrying out supportive transactions such as customer service and after-care.² It all happens in a spatial vacuum: not physically on any territory but in cyberspace.

Electronic commerce developed first as a business-to-business phenomenon but has, over the years, become increasingly oriented towards business-to-consumer – electronic retailing, a category that has grown with the advent of the World Wide Web (www). ‘There are now shopping malls over the Internet offering all manner of consumer goods from cakes to wine to computers and motor cars’ providing ‘an unprecedented opportunity for organizations of any size to reach a global customer base’³ over the world wide web.

As it has been aptly put, ‘Electronic commerce has implications for many facets of our economic and social life because it has the potential to fundamentally change the way commercial transactions, the business of government, the delivery of services and a host of other interactions are conducted, raising issues at the heart of policies directed at the regulation of traditional practices and procedures.’⁴ How will these changes impact upon the law, both nationally and internationally?

The pace is indeed breathtaking. According to the 1997 OECD Discussion Paper *Dismantling the Barriers to Global Electronic Commerce*, electronic commerce was predicted by most analysts to increase by a factor of ten by the year 2000.⁵ Early last month, the *Financial Times* reported a US research company as stating that the volume of business transacted over the net will this year reach \$180 billion.⁶ Notwithstanding this the electronic commerce market still remains relatively small in comparison to other types of commerce⁷ That is still a fraction of what can, and will undoubtedly, be achieved.

II The Regulation of e-commerce

The law must therefore follow fast on the heels of technological progress. It has to move quickly to regulate, to ensure fairness, to set the parameters, to combine justice and legal certainty, the foundations of a healthy and vibrant framework for commerce.

The further internationalization of business through electronic commerce raises new questions, gives new dimensions, to contractual legal relationships which span across more than one legal system.

Where did the transaction take place? What law regulates its formalities and its substantive clauses? What choice-of-law rules apply? Who has jurisdiction over the matter? What tax regime is to apply to the transaction and to the operating companies? Many of the questions are common to those raised by other legal relationships spanning over more than

¹ Source: *Internet Business*, Interest Verlag, Germany Augsburg 1997, from website: www.kite.tsa.de/e_com_index.html. As a matter of fact this definition is actually sourced from another author, David Kosiur, ‘Understanding Electronic Commerce’, 1997

² Kosiur, op cit.

³ Dorianne Mallia, *Electronic Commerce over the Internet*, 1998, Dissertation for B.Com. (Hons) Management, University of Malta, unpublished, at p. 12

⁴ *Electronic Commerce: Building The Legal Framework Report of the Electronic Commerce Expert Group to the Attorney General of the Commonwealth of Australia*, 31 March 1998 hereinafter referred to as ‘The Australia Report (fn. 6)’

⁵ Ibid.

⁶ According to ActivMedia, in Jean Eaglesham, op. cit. supra.

⁷ The OECD paper cited supra indicated that even a tenfold increase in 2000 would only make e-commerce world-wide as big as the size of mail order catalogue sales in the United States today in 1997.

one legal system. That is the realm of Private International Law or Conflicts of Law. The 'old' rules are being asked to answer to these new situations as cyberspace becomes a new reality for business.

The boundaries of electronic commerce are not defined by geography or national borders, but rather by the information technology and the coverage of computer and telecommunications networks. Electronic commerce operates in a fuzzy international environment that magnifies the problems that Conflicts of Law practitioners are familiar with, and further to that, adds the practical difficulty of applying Conflicts of Law rules to new technologies which have a bearing on the fundamentals of contractual regulation.

With e-commerce we need to understand how the technology functions in order to be able to apply legal principles, to find out, for example, how offer and acceptance are carried out, and, additionally we need to find answers to situations which, in cyberspace, lose all sense of defined territoriality, in order to be able to answer, for example the fundamental questions in international contract law disputes: Who has jurisdiction? What law applies?

As Johnson & Post⁸ point out:

Cyberspace radically undermines the relationship between legally significant (online) phenomena and physical location. The rise of the global computer network is destroying the link between geographical location and

- (1) the power of the local government to assert control over online behaviour;
- (2) the effects of online behaviour on individuals or things;
- (3) the legitimacy of the efforts of a local sovereign to enforce rules applicable to global phenomena; and
- (4) the ability of physical location to give notice of which sets of rules apply.

All of these, and other, legal issues revolve around the new testing ground of e-commerce as electronic commerce moves slowly, but inexorably, from the peripheral to the mainstream, as the market grows from one which is still essentially business to business to the wider additional market of business to consumer.

As in anything else, technology provides a medium which can be well-used or, instead, abused. The electronic age makes it more and more easy to set up 'fly-by-night' operations which defraud customers of their money, with companies closing down a web-site and opening others on new servers in other jurisdictions before being found out.

The cyberspace environment of e-commerce makes it increasingly easier to present sophisticated 'virtual' realities behind which, however, there may be, literally, absolutely nothing.

The law needs to counter this vulnerability with tools which are effective and render it increasingly more and more difficult to carry out e-fraud, in order to protect the honest business operator and ordinary consumers. The European Union is striving to respond to the need to regulate this new aspect of doing business across frontiers, although some critics state that its progress is too slow and that events will overtake its current pace.

In this short paper I shall consider some of the aspects of the European Union regulation of the electronic commerce sector.

III The European Commission's Communication

The European Union affords us an important example of the legal aspects of electronic commerce, because it is building up the legal framework to ensure that electronic commerce is regulated in a way that it can function within, and indeed enhance, the Single European Market.

In its first Communication on Electronic Commerce⁹ two years ago, the European Commission stated with vigour that

the pace and the extent to which Europe will benefit from electronic commerce greatly depends on having up-to-date legislation that fully meets the needs of business and consumers.

It therefore set itself a target

to implement the appropriate regulatory framework by the year 2000.¹⁰

One needs to build trust and confidence:

For electronic commerce to develop, both consumers and businesses must be confident that their transaction will not be intercepted or modified, that the seller and the buyer are who they say they are, and that transaction mechanisms are available, legal and secure.¹¹

There is need for certainty and peace of mind with regard to crucial issues in a transaction:

the identity and solvency of suppliers,
their actual physical location,
the integrity of information,
the protection of privacy and personal data,
the enforcement of contracts at a distance,

⁸ Johnston, D. & Post, D., 'Law and Borders — The Rise of Law in Cyberspace', 48 Stan. L. Rev. 1367, 1369-70 (1996)

⁹ A European Initiative in Electronic Commerce, Communication to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions COM(97)157.

¹⁰ *ibid.*

¹¹ *ibid.*

the reliability of payments,
 the recourse for errors or fraud,
 the possible abuses of dominant position¹²

With the exception of the last element mentioned, that of abuse of a dominant position which relates to the Competition regime within the European Union, all the other elements mentioned are of universal application¹³ and their effective legal regulation is required to ensure the success of electronic commerce world-wide. The following are some of the points raised by the Communication.

The Country of Origin Rule

The European Commission realized that it should not resort to over-regulation. Free movement of electronic commerce within the European Union could be achieved by mutual recognition of national rules so that companies engaged in cross-border business would operate under the law of their country of origin (home country control). Only where such recognition does not suffice to remove obstacles to trade, would the Community intervene. The 'country of origin' rule means that a company operating in any member state of the European Union would be able to operate anywhere within the Union's territory as long as it complies with the regulations of the country in which it is based.

The rule is not absolute and the Community may intervene to temper it with measures which, for example, would render consumers safer and with practically more secure and effective legal protection, something that is increasingly needed in e-commerce where you buy without physically examining your purchase.

Marketing of Financial Services

Member States apply divergent restrictions to the marketing of particular financial services to protect the public interest, causing a fragmentation of the Single Market for financial services, including financial services provided electronically.

Formation and the Performance of Contracts

The rules governing the formation and the performance of contracts in some Member States are not appropriate for an electronic commerce environment. They therefore generate harmful uncertainties relating to the validity and enforceability of electronic contracts. Examples include the requirements for written documents, for hand written signatures, or judicial

rules of evidence that do not take into account electronic documents.

Consumer Protection

As has already been indicated, consumer protection is a paramount preoccupation of the electronic dimension. The easier it is to defraud the consumer, the more important becomes the legal need to protect him or her. E-commerce places the consumer in a situation of even greater vulnerability ironically commensurate to the ease, and comfort of the facilities it affords. The law needs to retain that ease and comfort of operation while safeguarding the consumer in his or her relations of quasi-anonymous commercial operators. If a dispute arises, in which Court has jurisdiction over the issue? Do you have the right to return the product if the law of your jurisdiction allows this but the law of country where the purchaser is established does not give you such a right?

Electronic Payment Systems

Electronic commerce needs sound, user-friendly, efficient and secure electronic payment systems requiring an appropriate supervisory framework for the issuance of electronic money.

Fraudulent Use and Counterfeiting

Fraudulent use and counterfeiting, a truly serious concern for means of electronic payments, is not punishable throughout all the Member States of the European Union.¹⁴ Regulation must cover all non-cash means of payment and improve the security of new payment systems.

Data Security and Privacy

Data Security and Privacy is a must. Strong encryption will ensure the confidentiality of both sensitive commercial and of personal data. The EU not only seeks to remove barriers to use and importation of encryption technologies and products within its territory but also has a policy to seek such removal of trade barriers for encryption products at international level.¹⁵

Digital Signatures

Digital signatures also require a common legal framework encompassing the legal recognition of digital signatures in the Single Market and the setting up of minimum criteria for certification authorities. World-wide agreements on digital signatures are also required. This is crucial to building the

¹² *ibid.*

¹³ The Competition regulatory model of the EU has also been adopted by various countries.

¹⁴ Indeed it is punishable in only a minority of the member states of the European Union.

¹⁵ The OECD Cryptography Guidelines are a positive measure to strike international consensus on this matter.

confidence on the system for people to use it freely without hesitation.

Privacy

Safeguarding the right to privacy of the individual and of the commercial company is crucial to the success of e-commerce. The EU has a Framework Directive on the protection of personal data generically addressing this issue. There may be need for specific legislation on certain aspects which are triggered by electronic commerce.

Protecting Intellectual Property

The protection of copyright and related rights is considered by all as essential for the development of electronic trade. The legal protection needs to focus on online communications, reproduction and distribution of protected material, and also protection against the circumvention of anti-copy devices and electronic management systems.¹⁶ In the open environment of the electronic market place, the owner has greater difficulty in controlling abuse and legitimate use.

A Clear and Neutral Tax Environment

Tax obligations have to be clear, transparent and predictable. No extra burden should be placed on these new activities when compared with traditional commerce.¹⁷

Tax evasion is even more enticing in electronic commerce operating in an environment of speed, potential untraceability and anonymity. The revenue interests of government and the need to avoid market distortions and to protect the law-abiding businessmen and women requires legal regulation which address these fears.

Indirect taxation, particularly the widespread VAT system, applies to electronic commerce transactions and enforcement of this taxation also remains an important issue. The territorial concepts which underlie direct taxation systems ('residence' and the 'source' of income) also need to be examined in the light of commercial and technological developments.

The ruling concept for the European Union is that indirect taxation in relation to electronic commerce should re-

sult in the jurisdiction where consumption takes place. This was stated in the Commission Communication on Electronic Commerce and Indirect Taxation last year, and accepted by the July 1998 ECOFIN Council.¹⁸

A transaction that results in a product being placed at the disposal of the recipient in digital form via an electronic network is to be treated, for VAT purposes, as a transaction of services. These electronically delivered products may also be delivered by more conventional means in a tangible form and, according to their characteristics, be treated for VAT purposes either as a sale of services or of goods. Products currently treated as goods, such as supplies of music or video on disc or cassette may be subject to customs duties at importation. However products that, in their tangible form are treated for VAT purposes as goods are treated as services when they are delivered by electronic means. To my mind, software would fall under the latter category.

IV Aspects of the EU Acquis Communautaire in Electronic Commerce

i. Directive on Certain Aspects of Electronic Commerce in the Internal Market

The European Union has followed its initial Commission Communication with a set of Directives, Proposals and Drafts the very latest being the Amended Proposal for a European Parliament and Council Directive on certain legal aspects of electronic commerce in the Internal Market.¹⁹ This Amended proposal refers to the original proposal for a Directive which the Commission had published on the 18th of November of last year.²⁰

The proposed directive (and the proposed amendments) deals with the regulation of information service providers, commercial communications, electronic contracts, liability of intermediaries and other matters.

It provides for commercial communication to be clearly identifiable as such and for unsolicited commercial communication by electronic mail to be 'clearly and unequivocally identifiable as such as soon as it is received by the recipient'.²¹

¹⁶ The two WIPO, the World Intellectual Property Organization, international treaties adopted in December 1996 – the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty – are essential to stimulate and facilitate electronic commerce internationally. The EU shall aim for their early entry into force. Moreover, a successful outcome of the present WIPO negotiations on the legal protection of the substantial investment made in databases will constitute a further milestone in facilitating electronic commerce world-wide. (Communication, *ibid.*)

¹⁷ See below at fn. 18, Communication on this matter. The idea of a 'bit-tax' was discarded.

¹⁸ COM(98) 374 final. <http://www.ispo.cec.be/ecommerce/legal.htm#ecommerce>. The position adopted at the OECD's Ottawa conference is in line with the Commission's Communication.

¹⁹ COM (1999) 427 final, September 1999.

²⁰ COM (1998) 586 final, 18.11.1998.

²¹ Article 7.

With regard to electronic contracts, the proposed Directive lays down that there should be legislation in all Member States 'which allows contracts to be concluded electronically'.²² It does allow for exceptions such as contracts requiring a notary or which have to be registered with a public authority for validity, or governing family law or succession.

It also provides for explanations on how a contract is to be concluded to appear electronically to the non-professional contractor. Like the UNCITRAL rules, it lays down its own rules on when a contract is concluded, such as when a user clicks on an icon: the contract is 'concluded when the recipient of the service has received from the service provider, electronically, an acknowledgement of receipt of the recipient's acceptance'.²³

The Service Provider is obliged to immediately send an acknowledgement of receipt and that acknowledgement of receipt is deemed to have been received by the recipient when the recipient of the service is able to access it.²⁴

This is a simplified version of the original draft which considered a contract to be concluded only when the recipient of the service, is able to access the acknowledgement and sends his or her own CONFIRMATION of receipt of the acknowledgement of receipt.²⁵

ii. Electronic Signatures

Another area which the EU is covering relates to electronic signatures. Electronic signatures allow someone receiving data received over electronic networks to determine the origin of the data (identity) and to verify whether the data has been altered or not (integrity). The data is accompanied by a certificate, issued by a certification service provider, which allows the recipient of a message to check the identity of the sender.²⁶ Electronic signature therefore is a term which is used to refer to a range of technologies intended to ensure the security and certainty of electronic commerce, and in particular one of these technologies, namely digital signatures.²⁷

The latest document is the Common Position adopted by the Council on 28th June 1999 with a view of adopting Directive 1999/---/EC of the European Parliament and the Council.²⁸

The proposed Directive recognizes that electronic commerce 'necessitates electronic signatures and related services allowing data authentication'²⁹ and the need to have common rules relating to legal recognition of electronic signatures and accreditation of certificate-service providers in the Member States.

It does not seek to interfere with the parties' willingness to accept electronic signatures or to harmonize national rules concerning contract law: what it tries to achieve is a regulation of electronic signatures which raises the level of confidence in the use of electronic commerce and grants legal recognition to such signatures subject to the Directive's rules ensuring that they can be used as evidence in legal proceedings throughout the EU.

The Directive is aimed therefore simply to facilitate the use of electronic signatures and to contribute to their legal recognition.³⁰

It therefore creates a legal framework for both electronic signatures and for certificate-service-providers, that is, entities or persons who issue certificates or provide other services in relation to electronic signatures.

The main aspects of the proposed Directive are:

- * *Essential requirements*: an electronic signature meeting the requirements of the Directive is to be legally recognized and effective throughout the whole of the territory of the European Union.
- * *Legal recognition*: The Directive distinguishes between an electronic signature and an advanced electronic signature. An electronic signature is data in electronic form which are attached to or logically associated with other electronic data and which serve as a method of authentication. An advanced electronic signature also meets the following requirements:
 - Uniquely linked to the signatory
 - Capable of identifying the signatory
 - Created using means that the signatory can keep in his sole control

And

- Linked to the data to which it relates in such a way that any subsequent change of the data is detectable.

²² Art 9.

²³ Art 11 as amended.

²⁴ Art 11 (1) (a) and (b) as amended.

²⁵ Art 11 (1) (b) This was safer for the consumer but more cumbersome.

²⁶ Commission Communication Date: 13 May 1998 Electronic commerce: Commission proposes electronic signatures Directive.

²⁷ Australian Attorney General report, op.cit. supra.

²⁸ Common Position EC No 28/1999.

²⁹ ibid.

³⁰ Article 1.

An electronic signature cannot be legally discriminated against solely on the grounds that it is in electronic form.

However if the signature is an advanced electronic signature based on a qualified certificate and created by a secure-signature-creation device (defined in the Directive) then, throughout the Union, such advanced electronic signature shall:

- be deemed to satisfy the requirements of a signature in the same manner as a handwritten signature and
- is admissible as evidence in legal proceedings.

If a certificate and the service provider meet certain essential requirements, electronic signatures based on their service would benefit from an automatic assumption that they were legally recognized in the same manner as hand-written signatures. Furthermore they could be used as evidence in legal proceedings.

* *Certification*: Certification services can be offered without prior authorization: the market forces themselves will ensure that high levels of security to satisfy consumers' concerns are provided. Member States are free, however, to set up voluntary accreditation schemes for certification service providers in order to indicate special security measures or levels. On the other hand, Certification service providers wishing users of their certificates to benefit from a legal recognition of signatures based on their certificates, however, must fulfil certain essential requirements. The Directive lists these requirements.

* *International dimension*: To facilitate electronic commerce at world level; the proposal includes mechanisms for co-operation with third countries on mutual recognition of certificates on the basis of bilateral and multilateral agreements.³¹

iii. Directive on Distance Selling

This Directive,³² which was enacted in 1997 with a deadline for its implementation by all the member states which expires in the mid-next year, provides for additional protection for consumers with regard to distance selling such as is electronic commerce.

According to the Directive, prior to the conclusion of any distance contract, the consumer must be provided with clear and comprehensible information concerning:

- * the identity and possibly the address of the supplier;
- * the characteristics of the goods or services and their price;
- * delivery costs;
- * the arrangements for payment, delivery or performance;
- * the existence of a right of withdrawal;
- * the period for which the offer or the price remains valid and the minimum duration of the contract, where applicable;
- * the cost of using the means of distance communication.

The consumer must receive written confirmation or confirmation in another durable medium (electronic mail) at the time of performance of the contract.

The following information must also be given in writing:

- arrangements for exercising the right of withdrawal;
- place to which the consumer may address complaints;
- information relating to after-sales service;
- conditions under which the contract may be rescinded.

The consumer has the right of withdrawal. Where the supplier has met his obligations relating to the provision of information, the consumer has at least seven working days to cancel the contract without penalty. Where the supplier has failed to meet his obligations as regards information, this period is extended to three months.

Where unsolicited goods are supplied, the consumer's failure to reply does not constitute consent.

iv. Directive on Distance Marketing of Financial Services

The European Commission has recently published its amended proposal for a Directive aimed at establishing a clear regulatory framework for the marketing of financial services at a distance within the Single Market.³³ This follows the 'maximum harmonization' approach, and has replaced a two week 'warming up period' before the conclusion of the contract with an obligation on the supplier to provide a comprehensive set of information elements and by introducing a general right of withdrawal.

The aim of the proposed Directive is to ensure a high level of protection for consumers of retail financial services (insurance, banking and investment services) marketed by mail,

³¹ As in fn. 44. On 23 November 1998, the United Nations Commission on International Trade Law, also published the *Draft Uniform Rules on Electronic Signatures*. On 23 November 1998, the United Nations Commission on International Trade Law, made the Draft Uniform Rules on Electronic Signatures publicly available: http://www.un.or.at/uncitral/english/sessions/wg_ec/wp-79.htm .

³² European Parliament and Council Directive 97/7/EC of 17 February 1997 on the protection of consumers in respect of distance contracts. *Official Journal* L 144, 04.06.1997.

³³ Amended Commission proposal for regulatory framework for distance selling of financial services, 26 July 1999, following a proposal of 14 October 1998.

by telephone, by fax or by electronic means such as the Internet. Suppliers of financial services would be able offer their products throughout the Single Market, without the hindrance of having to comply with different national consumer protection laws on distance sales.

The consumer has a general right of withdrawal, without penalty and without giving any reason. Member States would be free to set the 'cooling-off' period between 14 and 30 days depending on the financial service offered. Those Member States which opted for the maximum period would nonetheless be obliged to accept the supply of financial services from other Member States with shorter withdrawal periods. Some financial services have been exempted from the withdrawal right (foreign exchange services, trade in securities, certain short term non-life insurance products, certain types of property loan) on the grounds that such a right would be incompatible with their correct functioning.

v. *The Brussels and Rome Conventions*

The Commission has already issued a proposed Council Regulation which will amend and substitute the existing norms in the Brussels Convention on Jurisdiction and on Recognition and Enforcement of Judgements. The Brussels Convention gives special attention to Consumer Contracts and affords the consumer the facility to sue in his own State of residence rendering legal proceedings more possible and effective.

The Commission has noted that the wording related to consumer contracts has given rise to anxieties among those looking to develop electronic commerce.

These concerns relate primarily to the fact that companies engaging in electronic commerce will have to contend with potential litigation in every Member State, or will have to specify that their products or services are not intended for consumers domiciled in certain Member States.

One such concern relates to the perceived problems with the notion of 'directing activities' towards specific markets, which is considered difficult to comprehend in the Internet world.

In order to further clarify the legal implications and requirements of electronic commerce, in particular in respect of jurisdiction and applicable law as a result of the development of trans-border electronic commerce, the Commission is currently organizing hearings, with the participation of regulators, legislators, consumers, industry and other interested parties.

Similarly the same preoccupation relates to the Rome Convention on the Law of Contracts³⁴ which also considers

consumer contracts. The preoccupations were recently voiced in an article in the influential paper, *European Voice*, published in Brussels referring to the hearings to be held in November on the proposed Commission legislative drafts.

Peter Chapman writes that

The hearings concern Commission plans to amend the EU's rule book to add changes already agreed to the Brussels conventions governing consumer's ability to seek legal redress in contractual disputes in their own courts (of residence) and proposals to amend the Rome convention which governs the law in such cases.³⁵

The Rome and Brussels convention rules will, firms fear, change the concept of the country of origin principle and constrain e-commerce firms to conform not only to the rule in their country of origin but also to the rules in the countries where their customers are based.

V *Choice of Law and Jurisdiction*

Everyone involved in electronic commerce agreements should pay particular attention to the issues of jurisdiction and choice of law. The advice, commonly given by lawyers to their clients world-wide, to ensure that contracts include a freely agreed choice of jurisdiction and choice of law clause become even more important for cyberspace.

Over the internet, the difficulties of arriving at the proper law of the contract, at the jurisdiction and legal system with the closest connection, multiply as one operates in an intangible environment.

A written choice of law clause and a written choice of jurisdiction clause therefore becomes more and more important. This does not mean that States will not be able to override such choice in the interest of public policy: that is the ultimate safeguard. One example of that relates to consumer contracts: there is an increasing consensus internationally at the level of the EU, OECD, WTO and others that the facilitation of e-commerce contract regulation should not be at the expense of the consumer who needs to remain protected as a matter of public interest.

VI *Festina Lente*

The Roman maxim of *Festina Lente* comes to mind in the way the international community should handle the legal regulation of e-commerce. To hurry slowly: to make rapid changes carefully and wisely. Although international business and not law is the driver in the industry, the lack of the necessary legal

³⁴ 1980.

³⁵ *European Voice*, Volume 5, 9-15 September 1999, at p. 3.

framework would seriously hamper the sector in its development.

The regulation of e-commerce must develop in an international dimension: e-commerce was born as a global reality. The European Union's regulation of electronic commerce can serve as a model for the regulation of this sector on a regional and global level. The EU cannot afford to carry

out the setting up of this legal framework at a leisurely pace. The International Telecommunications Union Telecom '99 in Geneva has shown that the advent of broadband technologies to the office and to the home further strengthens the technological environment for the development of e-commerce. The legal environment must match this without delay.