

# Law and E-Commerce: The Next Frontier

By Steven M.H. Wallman  
and Kathleen M.H. Wallman

Ever wonder why some of the largest and most state-of-the-art online brokers won't let you open an account online without your sending a "hard, written signature?"

It's because there is no uniform law, or certainty, on how to do the simplest bit of commerce in cyberspace: execute an electronic contract. And they're worried (maybe unreasonably, but worried nonetheless) that their contracts with their customers won't be honored.

Why? Because most commercial activity in this country is governed by state law. How we make contracts, whether a contract is enforceable, and which terms will be honored generally is governed by state commercial codes and contract law developed by state courts. And much of that law is ancient; it's derived from English common law.

This state-based system could have been a disaster when local commerce became interstate commerce, and interstate commerce became common. There could have been great confusion, uncertainty, and increased costs for any contract executed across state lines or any product or service ordered by mail.

But we've lived with these complications and, in fact, our system has worked reasonably well. That's because, in part, with a common English heritage and a

couple of centuries of being challenged and shaped by similar issues, the various states' laws have generally been pretty uniform. As the law evolved, judges understood the need for certainty and consistency, and the law was able to keep pace with business developments.

Additionally, most consumer transactions were—and still are—local: We buy what we need from a neighborhood store or office.

Finally, if the parties chose a state's law to govern their contract, another state traditionally would honor that choice, even if there were significant differences in the states' approaches. But there had to be some reasonable contact with that other state, such as by a party residing there, or by the services under the contract being performed there. And the parties first had to have an enforceable contract.

## The Challenge to Traditional Models

Technology, and the Internet in particular, now dramatically challenges and changes—at its core—this traditional model. One of the great strengths of cyberspace is its wide-open, no-standards format.

But when it comes to E-commerce, that strength is also a weakness. That's because there is less-than-perfect certainty

as to whether a contract executed in the virtual world will be honored in the real world. Additionally, in cyberspace, there's no easy way to verify addresses or the citizenship of buyers or sellers. They can be in Boston or Boise (or Belgium) with little to distinguish them at the other end of the transaction.

So what happens when the law of Massachusetts is very different from the law of

Idaho on an issue of importance? What happens when one state recognizes an electronic contract or digital signature and the other doesn't?

This is no mere academic exercise. A short time ago the idea of a Web site reaching millions of people around the globe was fanciful. Today billions of dollars are "commerced" over the 'Net, and no area of business is growing as fast. A few years ago no one knew what a Web address was. Today almost

no one advertises anywhere—in print, or on TV or radio—without highlighting one.

### What Law Applies: Some Possibilities

So what are we to do with the law—or at least the basic question of what law applies and whether, therefore, there is a valid contract? Here are some possibilities:

- Let legal rules, whatever they are or turn out to be, continue to evolve state by state. That would result in the enormous benefits of E-commerce being

burdened by continued legal expense and uncertainty.

Yes, eventually, state laws will become relatively uniform on these new issues. But unlike the last 200 years, the migration of consumers to E-commerce will be a lot faster than the movement from local toward interstate commerce, and the law's slow progress toward national certainty will be more costly here than in the past.

- At the other extreme, we could govern E-commerce at the federal level, or even try to promote international standards. But, at present, creating and a federal contract code for all of E-commerce and keeping it up to date would be extraordinarily difficult.

There's hardly any federal law relating to contracts—of any type—in existence today. There's no "Federal Contract Commission," and there's no likelihood that Congress soon will adopt the equivalent of a comprehensive federal commercial code.

Some have suggested that specific parts of E-commerce—such as digital signature procedures—be federalized, and legislation has been introduced reinforcing that suggestion. Still others have suggested that federal agencies, such as the Securities and Exchange Commission, set contract law and similar standards for the industries they regulate.

The first approach would create a hodge-podge of piecemeal or conflicting—and eventually stale—laws that overlay state laws. And it would carve out only a few parts of what's important to E-commerce.

Moreover, as the technology changes, is Congress going to be able and willing to revise the law quickly enough to ensure it's up to date? And what happens if one party uses an old-fashioned ballpoint pen and the

LET LEGAL RULES,  
WHATEVER THEY  
ARE OR TURN OUT  
TO BE, CONTINUE  
TO EVOLVE STATE  
BY STATE. THAT  
WOULD RESULT IN  
THE ENORMOUS  
BENEFITS OF E-  
COMMERCE BEING  
BURDENED BY  
CONTINUED LEGAL  
EXPENSE AND  
UNCERTAINTY.

other contracts with digital signature technology? Do we mix and match state and federal requirements?

The second approach—regulated industries having special contracting privileges—would result in no federal law and no certainty for nonregulated industries, potential conflicts between regulators, and favoritism for certain industries. None of this would solve the problem.

### A Better Option: Certainty in Contracting

There is a better course in between: That approach recognizes that the goal isn't necessarily to have uniformity in all laws, but certainty in contracting. A federal law could dictate that if a contract specified that a state's law should govern the contract, then that choice controls (with a default if the contract doesn't specify).

Such a federal choice of law provision would control no matter where the parties to the contract were resident (at least in the U.S.), no matter where the contract was to be performed, and regardless of whether there were contacts in the traditional sense with the chosen state. This would have two benefits:

- It would ensure that if a contract (made electronically or otherwise) were legal and enforceable under the laws of a specific state, then that state's law could be chosen, and the contract's enforceability would be certain.
- It also would obviate the cumbersome, fact-intensive analysis that state courts usually perform to decide whether the parties' specified choice of law should be honored.

It then would be left to the parties (and the states) to continue as they have since

the founding of the country to develop laws needed to facilitate commerce.

Under such a system, some states would develop a body of law that buyers and sellers, businesses and consumers, would find comprehensive, balanced, up to date, and consistently modified as the frontier changed.

Want to use digital signatures in an electronic contract? One state or another will provide the appropriate state-of-the-art procedures and safeguards to ensure their utility.

Want to make a contract by e-mail? A state's law would ensure that it was enforceable.

Such rapid evolution would be similar to what's happened with the body of laws governing corporations. Most companies are incorporated under the laws of just a few states—not because that's where the founders or their lawyers reside, but because these laws are known to be thoughtful, consistently updated, and expertly administered. (And, of course, the states have an incentive to maintain their laws because of their importance and the fees they receive from companies incorporating there.)

THERE IS A BETTER COURSE IN BETWEEN: THAT APPROACH RECOGNIZES THAT THE GOAL ISN'T NECESSARILY TO HAVE UNIFORMITY IN ALL LAWS, BUT CERTAINTY IN CONTRACTING.

For E-commerce law, consumer groups and lawyers would monitor state laws and influence them, as would businesses. With clearer laws, backed by a federal choice of law provision that would ensure that the parties' choice would be enforceable, costs and uncertainty would be reduced substantially.

In addition, diversity and innovation would be fostered as different approaches are tried in various states. But because businesses, membership organizations, publications, or others doing business nationwide could pick one state's law, costs of complying with 50 disparate state laws would be eliminated.

### A Quandary for States: Business v. Consumers

Any state law that tilted too much toward businesses would find consumers not using it; consumer groups would alert others not to do business with any merchant selecting that state's law. Similarly, any state law that tilted too much toward consumers would find businesses not using it.

Alerts about biased laws would be provided by the media and on Web sites. Just as happens with corporate law, a reasonable balance would be achieved, since it is in everyone's long-term interest to have fair laws.

Would this be the perfect solution if one were starting all over again? No. But we write on a heavily scribbled slate. We can wait for the perfect solution, but it will be a long time in coming.

Meanwhile, the promise of E-commerce and new technologies can be realized—or at least significantly promoted—by a very simple law that could be adopted quickly at the federal level and that empowers states to do more effectively what they've been doing for centuries.

---

*Mr. Wallman, a former Securities and Exchange Commissioner, is a senior fellow (non resident) at the Brookings Institution. Mrs. Wallman is president of Wallman Strategic Consulting LLC, a telecom policy consulting company based in Washington, D.C. She formerly was a senior official with the National Economic Council and Federal Communications Commission.*