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Federal Trade Commission and National Telecommunication Administration 2001 Workshop on E-SIGN Provisions Relating to Consumer Consent to Receive Information Electronically

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These comments are being submitted in response to a request from the Federal Trade Commission and National Telecommunication Administration for comments on the benefits and burdens of requiring consumer consent to receive information electronically pursuant to Electronic Signatures in Global and National Commerce Act Sec. 101(c)(1)(C)(ii).

I. Qualifications to Comment on E-SIGN Consumer Consent Provisions

I am a professor at the Dedman Law School, Southern Methodist University, Dallas TX. I have taught commercial law at SMU for eleven years, am co-author of The Law of Electronic Commerce, 4th ed. (2001), the leading treatise on electronic commerce law, and have written many articles on electronic commerce law topics which are available from my website at www.smu.edu/~jwinn. I am active in the American Bar Association Cyberspace Law Committee Subcommittee on Electronic Commerce law, have taught electronic commerce law at SMU since 1997 and speak widely to legal and business groups regarding electronic commerce law issues and developments. I do not represent any clients with an interest in the consumer consent provisions of E-SIGN. These comments represent my own opinions as an academic observer of electronic commerce law developments and do not represent the opinions of Southern Methodist University, the American Bar Association or any clients I represent on other matters.

II. Potential Contribution of Consumer Protection Law to Regulating Electronic Retail Markets

Consumer protection law has an important contribution to make to the development of electronic commerce markets in which individuals enter into transactions for goods and services for personal, family or household use. Many modern US consumer protection laws may be justified as an attempt to counteract substantial risks of market failure and economic inefficiencies due to the basic institutional characteristics of consumer markets. Consumer protection law may be designed to counteract possible market failures based on unequal bargaining power, information asymmetries, collective action problems and bounded rationality that limit the ability of consumers to enter into fair and efficient contracts with merchants. The dominant approach taken to these problems in US consumer markets has been to subject certain types of consumer transactions to mandatory rules governing their formation, performance and enforcement. Common forms of consumer protection contract rules mandate the use of certain terms, disclosures, or contract formation processes.

Electronic retail markets are evolving rapidly. This transformation of consumer markets is likely to change the current distribution of benefits and burdens among the parties to consumer transactions. Some of the most important potential benefits for consumers of transforming traditional markets into electronic markets include increased competition among merchants and lower transaction costs. Some of the most important potential benefits for merchants include reduced competition through the successful promotion of proprietary technologies in electronic retail markets, and lower transaction costs that might translate into higher profits rather than lower prices. Some of the most important potential burdens for consumers in electronic markets include the expense of coping with rapid obsolescence and lack of reverse compatibility in retail software and hardware products; and lack of competition among providers of retail electronic commerce products due to the dominance of proprietary standards and lack of market adoption of open standards. Some of the most important potential burdens for merchants include the same expenses associated with rapid technological obsolescence. The approach taken by regulatory agencies with a mandate to protect consumer interests in retail markets to such as the FTC revising and updating existing consumer protections laws will be an important factor in determining how many benefits and burdens US consumers are expected to have when they use retail electronic markets.

Technological innovations now being developed or deployed in electronic consumer markets hold the promise of leveling the playing field between merchants and consumers, but it is not inevitable that promise will be realized. One possible outcome of such a change is that consumers will be able to enter into transactions on terms that are more equitable and efficient than is possible in consumer transactions in more traditional markets. Another possible outcome is that merchants dealing with consumers will benefit from greater processing efficiency in consumer transactions without passing on any substantial portion of those benefits to consumers. A third possible outcome is that the developers of the technologies that make up the network architecture of electronic

consumer markets will benefit from widespread adoption of their products while limiting the volume of benefits that are enjoyed by either merchants or consumers.

Recent developments in the information privacy arena indicate the possible consequences of failing to act on behalf of consumers at the time technological standards are developed. Many of the consumer data collection and profiling practices that are commonplace in Internet commerce today are such well established business practices that it may prove difficult to modify or stop them even if strong information privacy rights are enacted into federal law. Merchants that have invested in information technology that permits profiling will resist making major investments in newer technology with fewer functions. If markets have in fact standardized on technologies that do not accommodate information privacy rights for consumers, positive network externalities from continued use of that technology combined with the risk associated with switching to alternative technologies before new network standards and the price of acquiring alternative technologies may prove to be major obstacles to changing business practices in US markets.

There is the same potential for conflicts of interests between retail merchants and consumers with regard to the standards that will define contract negotiation and contract formation technologies in the next generation of Internet commerce as there is in the arena of information privacy rights. If government regulators focus on fighting the battles of the 1950s over again and fail to address the consumer interest in open and fair standards for electronic retail marketplace technologies, an opportunity may be lost like the one that was lost to influence Internet merchant data collection practices.

III. Analysis of Strengths and Weaknesses of E-SIGN Consumer Protection Provisions

The strengths of the consumer protection provisions of E-SIGN include:

1. Recognition that market failure may occur in electronic retail markets as well as traditional retail markets, and that regulation may correct such a market failure; and
2. Allocation to merchants rather than consumers of costs of lack of reverse compatibility, competition and standardization in retail electronic markets.

The weakness of the consumer protection provisions of E-SIGN include:

1. Preserving like a fly in amber 1950s tools for consumer protection that are no more effective in electronic retail markets than they were in traditional retail markets;
2. Failure to analyze the transformative impact of technology on patterns of merchant misconduct that occurred in traditional retail markets; and
3. Failure to generalize from recent consumer protection debacles such as information privacy rights the implications of technological standards for consumer contracting technologies.

The consumer consent provisions in E-SIGN are badly designed and unlikely to result in any substantial empowerment of consumers in electronic commerce transactions. The consumer consent provisions in E-SIGN focus on preserving the substance of pre-existing consumer protection laws that require disclosures to be made to consumers in writing as part of a consumer transaction. Only in cases where there is such a pre-existing requirement to provide a written disclosure exists, and the other party to the consumer transaction wishes to meet its obligation to provide disclosures using electronic media, then E-SIGN mandates certain contract formation processes. The consumer consent provisions in E-SIGN are fundamentally flawed in three ways: if requiring a merchant to show that a consumer consented to the use of electronic media is a worthwhile consumer protection, it should not have been limited to situations where there is a pre-existing requirement that the consumer receive written disclosures; it seems likely to impose costs on merchants that comply with it that are disproportionate to the benefits consumers receive from that compliance; and it fails to provide incentives to create a network architecture that will enhance actual competition in electronic consumer markets.

The prohibition on oral communications in the consumer protection provisions in E-SIGN is a clear example of backward looking thinking likely to stifle innovation without producing a significant improvement in the terms and conditions on which consumers do business in electronic retail markets. This exclusion of oral communications from the general provisions of the E-Sign bill overlooks the fact that more powerful forms of communication and computing are blurring the distinction between such basic interpretative categories as oral and written, or form and content. If a text is stored on a computer system, new dynamic systems for organizing information will permit the consumer to choose a text-to-speech audio interface in lieu of a graphical display of the text. Likewise, a consumer can input information into a system using speech recognition software in response to audio prompts. Canons of interpretation assigning significance to the differences between text and speech, or in the appearance of handwritten or printed texts, may provide little or no guidance in interpreting dynamic user interfaces. In a face-to-face transaction, a rogue employee of a merchant or a merchant wishing to defraud consumers might make oral representations to a consumer that would later prove unenforceable. In a wholly automated transaction, a consumer is interacting with machine processes, and the problem of the rogue employee is eliminated. Audit trails of electronic processes make it more difficult for merchants wishing to defraud consumers to cover their tracks effectively. In a wholly automated environment, by contrast, a user interface could actually be designed that would improve the likelihood that a consumer understands and can act on the information contained in a text disclosure if the contents of the text are communicated as through an audio interface rather than a graphical interface.

IV. Role of Standard Setting in Protecting Consumers and Promoting Competition in Retail Markets

Requiring merchants to provide disclosures to consumers is a major form of consumer protection law in the US today. Many disclosure laws were enacted in the hope that consumers would be able to make more rational decisions in retail markets and that creating a level playing field among merchants would promote competition that would benefit consumers. In many contexts, it must be recognized that mandatory consumer disclosures are a failure if they were intended to help consumers make more rational decisions and to promote competition. Providing consumers with dense masses of legal boilerplate, even if it has been rendered into "plain language," is unlikely to translate into a concrete improvement in the understanding among consumers of the relevant terms and conditions of the transaction.

Mandatory consumer disclosure laws are not always failures, however. If disclosure promotes standardization in setting the terms and conditions of transactions and the mandatory disclosure standards are also designed to communicate important information about essential terms, consumers may be able to extract useful information from disclosures and act on them. In regulating the electronic retail marketplace, the emphasis should be shift from disclosure as an end in itself, in which case it is highly likely to fail to achieve its objectives, to standardization as the objective, with mandatory written disclosures as one means of achieving that objective.

If regulators focus on preserving anachronistic and unsuccessful models of consumer protection law in electronic retail markets, then they risk creating nothing but Internet "Maginot Lines."[1] The Maginot Line failed to protect France from a German invasion in World War II because it failed to consider new sources of threats to France's territorial integrity. If consumer protection authorities focus on historical models of consumer protection without considering the new challenges posed by potential for strong network effects in electronic retail markets, efforts such as the consumer protection provisions in E-SIGN to protect consumers may turn out to be too little, too late to achieve their intended ends.

The experience of US consumers in recent years shows that competition on price may intensify in electronic commerce markets resulting in lower prices for consumers for a wide range of goods and services. The experience of US consumers in recent years has not shown that competition will intensify on many other terms of consumer electronic transactions, such as warranty terms. For example, it is difficult if not impossible at present to find a single Internet site maintained by a major US retailer that complies with the pre-sale disclosure requirements of Magnusson-Moss. As a result it is not possible to compare the terms of warranties offered for consumer goods over the Internet to determine if differences in price is offset to some degree by the provision of less favorable warranties. This problem could be overcome through the development of

[1] In France, following World War I, the Maginot Line was created as a supposedly impregnable defense against foreign aggression. The Nazis quickly overran the Maginot Line in 1940 because the Maginot Line only protected France from attack along the Franco-German border, not along the Franco-Belgian border. The Germans entered France after overrunning Belgium in only a matter of days, outflanking the Maginot Line defenses. "Maginot Line," in Encyclopedia Britannica, available at http://www.britannica.com/bcom/eb/article/4/0,5716,51214+1+49999,00.html?query=maginot%20line

electronic agent technologies that could analyze the terms of different transactions and report back rankings to consumers based on the degree to which different transactions conform with their stated preferences. Consumer electronic agent technologies will fail to achieve this potential, however, unless merchants develop standards to permit the automated analysis of all the relevant terms and conditions of retail transactions, not just terms that are easily convertible into machine-readable formats such as price and stockkeeping unit (SKU) numbers.

The structure of the consumer consent provisions in E-SIGN treats the risk of rapid obsolescence and the lack of interoperability and version control in the technology of electronic consumer markets as a burden that can be allocated by law to either consumers or merchants dealing with consumers. This overlooks the possibility of reducing the burden to both merchants and consumers by influencing the behavior of technology developers who today profit from planned obsolescence and lack of interoperability of proprietary formats.

Standard setting for Internet retail commerce is taking place today in a decentralized, ad hoc fashion that is likely to reflect the interests of technology developers and merchants, but may overlook the interests of consumers. Merchants are likely to have a business incentive to participate in standardization processes notwithstanding the expense in order to take advantage of emerging technologies such as XML.[2] Designed as a successor to the much simpler and less flexible HTML standard for coding Web pages, XML will permit the organization of information in Internet documents to be standardized. Once it has been standardized using XML, information can be communicated in many different formats including display in a Web browser or on the screen of a cell phone. By converting their existing Internet content to XML standards, Internet merchants may find it easier to participate in integrated Internet markets that bring together more vendors and purchasers than an individual Web site can hope to attract.

The interests of consumers in the development of applications and interfaces that permit electronic consumer transactions to take place are often adverse to the interests of merchants and technology developers. For example, consumers might be found to have a very substantial interest in knowing whether a merchant has included a mandatory pre-dispute alternative dispute resolution clause before they enter into a transaction and whenever possible, would prefer to do business with merchants who do not include such provisions in their contracts. Merchants, by contrast, may find such provisions important in increasing their profitability if they can be used in contracts and consumers are unable to distinguish between merchants who use such provisions and merchants who do not. For example, in order for consumer activated electronic agent software to permit

[2] XML is a successor to HTML, the standard used to create Web pages. XML will promote the expansion of Internet commerce by permitting the information exchanged in Internet commerce transactions to be organized according to the business objectives of the parties. Instead of labeling text "title" or "paragraph" as is possible with HTML today, text would be labeled "price" or "quantity" using XML in the future. Internet browser software or other applications would be able to recognize the difference between different terms and help individuals to organize and sort information.

consumers to distinguish between merchants who insist on mandatory pre-dispute ADR provisions and those that do not, technology developers would need to work with merchants to standardize the way mandatory pre-dispute ADR provisions are expressed in contracts so they can be identified without human intervention.

If contract terms that are of particular interest to consumers are incorporated into standard-setting processes, then consumers will be able to make greater use of electronic agent software to perform automated searches and comparisons of transactions. If such terms are omitted from this standard setting process, then the developers of electronic agent software will be limited in their ability to automate search and analysis functions on behalf of consumers. If contract terms of particular interest to consumers are omitted from standards, once the next generation of electronic commerce technologies have been developed and implemented, it will require a change in standards to add functions that will permit consumer-activated electronic agents to perform automatic searches and analyses. If the modification in standards required to add functions is significant, then problems of path-dependency and lock-in may interfere with the ability of regulators or consumers to demand that merchants add those functions.

V. Potential Role of FTC in Promotion of Consumer Friendly Standards for Electronic Contracting Interfaces in Retail Markets

Dozens if not hundreds of separate efforts are now underway to develop standards for the next generation of Internet commerce. Over the next few years, there will be intense competition among the technology companies developing applications based on these standards. It will not be possible to predict who will be the ultimate winners and losers for several years, but it is possible to predict that only a small number of the contenders under development today will survive. For example, the Gartner Group recently released a study predicting that by 2005, only two or three of the XML standards now under development will be in widespread use, and those standards will account for almost all Internet commerce transactions. Today a window of opportunity exists to influence the framework within which the next generation of Internet commerce will be carried out by influencing the standard setting efforts now underway.

In order to promote the expansion of consumer choice and competition in consumer markets when the next generation of electronic commerce technologies are in place tomorrow, lawmakers need to find opportunities to encourage standard developers to take consumer interests seriously today. Individual consumers and even established consumer advocacy organizations do not have the resources to locate and participate in the dozens and hundreds to standard developing projects underway today. Such a huge undertaking is even harder to justify in light of the fact that out of the dozens and hundreds of projects underway today, only a tiny handful will ultimately become widely adopted in the future, and that no one today can predict accurately which projects today will succeed and which will fail. If consumer interests are to be taken seriously, then some system for representing consumers indirectly in today's standard developing projects needs to be found.

The Federal Trade Commission should see authority from Congress to identify relevant standard setting efforts now underway and analyze content; identify appropriate incentives to promote substantial consideration of consumer preferences in the development of standards; and analyze the functions of electronic agent software now under development in light of prospective consumer preferences in electronic markets. If regulators collect and analyze this information, then they will be in a position to make decisions about how consumer interests in the standard developing process can best be protected. Advances in information technology may contribute to overcoming market failures based on unequal bargaining power, information asymmetries, collective action problems and bounded rationality that today limit the ability of consumers to enter into fair and efficient contracts with merchants. That potential will only be realized if important consumer interests are taken into account now while standards for the next generation of electronic commerce technologies are still being developed. If regulators can promote the development of fair, open standards now, then the next generation of electronic commerce technologies may permit US consumers to enjoy in full measure the potential benefits of new technologies in retail markets.