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# **Regulatory Innovation and the Online Consumer**

Colin Scott\*

## **1. Introduction**

The explosion of usage of the internet has caused considerable anxiety concerning the capacity of states to fulfil the functions they have developed in protecting consumers (Biegel 2001). Online business is booming in many sectors. Key examples, investigated in this article, are online investing, gambling and e-shopping (sale of goods via the internet). It has long been recognized that contemporary commercial practices present consumers with informational problems. These difficulties are liable to be amplified in the online world because of the dependence consumers experience on what they see on their screens for information about such central matters as the subject matter of the transaction and with whom and where they are transacting.

For states the problem of protecting the online consumer arise from a cascading set of issues. It may be difficult to identify and/or locate businesses. Where businesses are readily identifiable their location may be outside the jurisdiction of the state in which the consumer is located. Consequently it will be difficult to apply the regulatory apparatus of the consumer's state to the issue. The state in which the business is located may regard itself as having no stake in the issue or may not have the apparatus or the norms to cover the matter. This is the policy problem of 'the globalised consumer' (Harland 1999). Though inter-jurisdictional problems are not new – investment frauds, for example, can be perpetrated from overseas by the older technology of the telephone (Australian Securities and Investment Commission 2002a, 2002b) – widespread use of the internet increases the scale and significance of problem transactions.

It appears unlikely that approaches based on traditional mechanisms of ‘command and control’ and hierarchical application of law will fully address the issues. Few areas of activity could be more in need of a dose of regulatory innovation. In an earlier article, written jointly with Andrew Murray (Murray & Scott 2002), I have indicated that Lawrence Lessig’s (Lessig 1999) analysis of the different ‘modalities of regulation’ is helpful in considering the alternatives to the hierarchical mode of regulation which he referred to as law. We offered a critique and elaboration of some elements of the high level analysis. Though we supported Lessig’s view that there are four ‘pure’ modalities of regulation: law (reclassified by us as hierarchy), norms (community), markets (competition) and architecture (design) we hinted at the possibility of a more complex analysis which considers variety in control not only in respect of regimes themselves but also in the various components of regimes. Working from a cybernetic analysis of control we can see that a regulatory system has three components: some goal, standard, rule or norm to which the system refers; some mechanism for monitoring or feeding back into the system information about the performance of the system against the goal; and some mechanism for realigning the system when its operation deviates from the goal. Within classical regulation these components are represented by rules, agency monitoring and the application of sanctions. But each of the other modalities of regulation possesses functional equivalents of these components.

Consideration of variety in control at the level of each of these components of regulatory regimes enables us to explore the extent to which problems presented by internet transactions both to consumers and states have generated innovation in regulatory practice. Innovation is defined here to refer to the bringing of established technologies and ideas to new circumstances and problems. I suggest that while regulatory innovation has been a key meta-principle of regulatory reform, high level discourse fails to capture the variety which such regulatory innovation in the practices of the online world. The hypothesis offered to explain this dissonance is that whereas regulatory scholarship recognizes the diffusion of the resources and capacities relevant to control within regulatory regimes (Hancher and Moran 1989; Shearing 1993; Daintith 1997; Black 2001; Scott 2001) public policy analysis of regulatory reform been more wedded to a

government-centred perspective. Accordingly the meta-principle of innovation is applied only to those policy changes which are within more or less direct control of governments and their agencies. Such an approach neglects the evidence of and capacity for innovative strategies of control by other key groups such as businesses, non-governmental organizations (NGOs), and consumers.

## **2. Consumers and Online Transactions**

The development of e-commerce has been attractive for at least some consumers who have seized on its possibilities with enthusiasm. There are a number of distinct reasons why consumers might favor online transacting over more traditional forms of intermediation. These reasons are paralleled with the suppliers of products. First, there are potential price savings, accruing from: reduced costs for traders who do not have to maintain costly shop-front premises and/or who can buy in bulk; the potential for avoiding local taxes (Zittrain 2003); the creation of new markets for highly perishable services (such as flights and hotel accommodation) which service providers are willing to offload at substantial discounts provided they can charge above marginal cost (an Australian example is [wotif.com.au](http://wotif.com.au)). Second, online transacting might reduce search costs by enabling comparison of products and prices from the comfort of a computer screen (Elkin-Koren and Salzburger 1999: 561). Third, consumers may be able to purchase goods and services with (at least a perception) of greater privacy. Fourth, and relatedly, they may be able to acquire products the supply of which is prohibited within their own jurisdiction either by public law or by licensing or other agreements made by producers. A central example of this is online gambling. Fifth, consumers may be able to benefit from greater immediacy with highly time sensitive transactions (such as stock purchases) (Bradley 2003). Sixth, the internet may enable consumers to find sellers (and indeed buyers) for goods and services which can readily be supplied to a remote location but where it might otherwise be difficult to locate such persons (Ebay.Com provides a key example of the internet providing intermediation for this kind of service, though it applies also to niche market e-tailers such as sellers of rare books and maps). Seventh,

and relatedly, the internet may create markets in transactions for which payments are very small.

The internet has accelerated an already observable trend away from a model of consumption based largely in town and city centers. In many cases businesses trading on the internet have no 'bricks and mortar' operation at all, and there is no possibility of visiting their premises. Consumers may be unaware of the location of the trader with whom they are dealing. The peculiar problems faced by consumers in online transactions are largely related to information (Elkin-Koren and Salzburger 1999: 559). On the one hand the space provided by the internet for describing products and supplying images, and the potential for comparing the offerings of different traders, or locating independent product reviews, may reduce search costs and enhance the information available to consumers about the product (whether goods or services) to be supplied. On the other hand online consumers may have informational disadvantages as compared with their bricks and mortar brethren for example in respect of reliability and quality. As with goods and services ordered by telephone or post, consumers can rarely try before they buy. Products may meet their specification but still disappoint their new owner. Even where traders offer no quibble money back guarantees (as with many suppliers of goods) some of the cost of returning products often falls on the consumer. With services there is less potential for such guarantees. An online bet is consumed before the consumer is liable to become disappointed. It is in the nature of online investing that there can be few guarantees. There are good reasons why consumers have historically relied on trusted intermediaries in their transacting behavior and stripping them out of transactions creates risks (Shapiro 1999: 104). The greater the expertise required to assess the wisdom of a transaction the greater the risks. For this reason online investing presents particularly accentuated risks (Shapiro 1999: 145).

Where consumers can acquire good information about the product to be supplied, they may lack key information about the transaction. First they may not know who they are dealing with. This is of little consequence when the product is supplied in conformity with expectations. But where things go wrong it may be fundamental. A traditional

consumer can visit the premises of the supplier, and if necessary cause a lawyer's letter or legal claim to be delivered. Most traditional businesses value their reputations sufficiently that they have incentives to seek solutions to problems which are acceptable to consumers, often in excess of legal rights, or offering remedies not provided for by law. These informational problems are perhaps most acute in the case of fraud – for example where money is taken with no intent to supply the product or no intent to supply a product which conforms to expectations. Even in the absence of fraud such problems as non-delivery, defective products and over-charging can be far from straightforward. When the consumer has full information about the supplier, they are unlikely to be aware of which legal rules govern the transaction or what remedies are available. Securing the remedies which are, in theory, available may be difficult where the trader is located in a different jurisdiction. The starting focus of the paper is on the problems faced by consumers in online investing. Since regulatory innovation relevant to online investing may occur in other domains, the paper also assesses problems in two other consumer sectors – online gambling and e-shopping, so as to be able to draw on wider patterns of regulatory innovation.

#### **a. Online Investing**

The development of online investing has greatly increased the ease with which consumers can secure market information, while reducing the costs associated with trading shares. This development has occurred at a time when many jurisdictions have sought to tighten regulation over the supply of market information to better fit with developing social practices, 'with dramatic overhauls of the systems of financial regulation' (Bradley 2003). Consumers may find it very difficult to evaluate information which they find on the net, and accordingly may make unwise investment decisions. Indeed there is some evidence that the internet has encouraged a form of systemic lack of wisdom, as consumer investors have greatly enhanced the number of transactions in which they engage, neglecting long-established investment principles which advocate long term holding of stock. It is suggested that the increased availability of information in the internet has generated over-confidence in small investors (Barber and Odean 2002:

456-7). For governments and public agencies concerned with securities regulation there is an interest both in maintaining confidence in the market and in protecting those who are vulnerable, particularly small investors. These concerns have recently led to the proliferation of rules concerned with investment advice and those who give it (Bradley 2003). The theory is that if the advice is good, or at least well regulated, the transactional problems which might arise are less serious. A key regulatory problem with online investing is the diffusion of those offering information which might be construed as advice. Small investors are no longer restricted to the newspapers, specialist magazines and financial advisers. They can now tap into a wide variety of commercial information services and non-commercial websites and chatrooms to glean and compare information. Many providers of what, within the regimes, will often count as advice, are difficult to identify or located in only one of the jurisdictions in which the advice may be considered and acted on.

## **b. Gambling**

Governments have taken an interest in gambling for two main reasons. The first is that they wish to limit the extent to which their citizens lose money to bookmakers and to others whose main businesses is the taking of gambling money. The other main interest, and one liable to push governments in contradictory directions, is a wish to secure tax revenue from gambling transactions. Online gambling may be attractive because it enables consumers to avoid either local taxes or local prohibitions. However, the market for online gambling is also driven by considerations of convenience and immediacy. The ease with which consumers may privately lose their shirts on the internet has caused a number of jurisdictions to ban online gambling of various kinds. Australia's Interactive Gambling Act 2001 creates an offence of providing interactive gambling services to customers physically located in Australia (s.15). The Act specifically excludes from the offence the provision of betting services by telephone (s.5(3)), wagering on sports events (s.8A) and online lotteries (s.8D). The Act has driven many Australian consumers offshore (even though the offence purports to apply to service providers wherever they are located in the world) while causing local firms to seek business overseas. The

Australian Act provides that the ban may be extended to customers in other designated countries where those countries have similar bans and their countries request it (s.15A). Many US states ban online gambling. These prohibitions have created valuable new markets for firms in countries which permit and regulate internet gaming, such as the UK.

The informational problems faced by online gamblers are varied depending on the type of product which they are purchasing. Online betting over sporting events may present few problems since details of the event and the odds can readily be verified through other media sources (and, as noted above, this form of gambling is excluded from the Australian ban). Provided winning bets are paid all is well. Online gaming is a different matter. Where gaming machines are permitted in the real world they are typically tightly regulated as to the percentage of their take which must be paid out in winnings and machines are subject to inspection and verification to ensure they conform to these standards. Just as consumers cannot check this for themselves with real world gaming machines, so they cannot check what the odds are with online gaming. Just as suppliers can evade bans through re-locating so can they avoid local regulation of such matters as the odds faced by punters. Casino games are more difficult to regulate in the real world, but easier to fix in favor of the supplier when online. Governments seeking to protect either consumers or tax revenue struggle to assert regulatory control over gaming operations established in other jurisdictions. The absence of international consensus, even with the OECD, on the appropriate norms and mechanisms for online gambling make the matter more problematic.

### **c. E-Shopping**

E-Shopping is emblematic of the online revolution with the potential for substantial reductions in prices and transactions costs for consumers. As with real world transactions the potential problems faced by online consumers typically relate to such matters as : misrepresentation of what is being offered; non-delivery; delivery of sub-standard goods and services; failure to remedy defects (Treasury 2001). These problems arise particularly

in respect of e-shopping for products which still require physical delivery to consumers. Where products can be delivered digitally (as with software, music or video) then delivery may be more or less instantaneous.

Many e-tailers are seeking to build up reputations as model traders and are likely to seek to resolve consumer complaints rapidly, often granting remedies in excess of legal rights (for example offering refunds to consumers who change their minds even after the end of any mandatory cooling off period of the kind that applies to distance sales in the European Union). Where businesses are unresponsive in the face of consumer complaint lack of information about location and applicable rules may make it difficult to know, let alone assert, rights. The inadequacy of private law has been addressed in part through the development both of new enforcement rules and new remedies applying to consumers engaged in cross-border transactions and the opening of new avenues of redress. Perceptions of the failure of private enforcement mechanisms to protect consumers generally in the post-war period led to the expansion of the role of public agencies charged with a more proactive monitoring and enforcement of public regulatory rules for traders in many OECD countries. In the online world public agencies come up against similar jurisdictional problems to those faced by consumers, and these problems are magnified by a general unwillingness in courts to permit the enforcement of public regulation extra-territorially.

### **3. The Discourse of Regulatory Innovation**

There are a number of apparently competing stories about the relationship between regulation and changes in the environment in which it operates. One regulation narrative emphasizes the difficulties that regulatory policy has in keeping up with the impact of technological changes and the policy problems which it throws up. Another highlights a meta-principle of innovation at the heart of contemporary regulatory policy which, converse to the first narrative, might lead us to expect regulation to be rather responsive to the challenges of technological change. Which narrative one prefers is in part a function of how regulation and innovation are defined.

### **a. Regulation**

It is difficult to deny that the institutions and practices of regulation form a key part of contemporary public policy discourse. What is less apparent is that the participants in the discourse often have in mind somewhat different meanings of the term regulation. An emergent literature contrasts definitions which identify regulation as that distinctive policy instrument which operates through sustained oversight by reference to rules with those that encompass all governmental intervention in the economy and, most broadly, all forms of social control, whether part of an intended system or not (Baldwin, Scott, and Hood 1998; Black 2001; Daintith 1997). Whilst the narrowest of these definitions makes us think of regulatory agencies overseeing compliance with a prescribed set of rules, the last definition encompasses not only governmental activities, but also controls which are linked to the generation and enforcement of social norms and the standard-setting, monitoring and behavior modification functions of markets. In terms of public policy it may be helpful to think both of the distinctive type of instrument of the first definition *and* to recognize that once we are considering a particular regulatory domain then the means to address shortcomings may lie in recognizing the actual or potential role of other forms of control. Thus the narrow definition forms a starting point, but to conclude the matter there, and exclude all other control mechanisms from the inquiry, would leave us with only a partial view both of how the regulatory domain was controlled in practice and what the potential was for enhancing controls geared towards delivering public-regarding outcomes.

The quite deliberate slipperiness in defining the concept of regulation has particular purchase in respect of the problems of the online world. It is clear that the emergent social and commercial practices spawned by the internet represent a complex product of governmental, social and market interaction. Accordingly it would appear that the emergent problems could never fully be addressed by governmental action in isolation. This is an application of the law of requisite variety which suggests that control mechanisms must exhibit at least as much variety as the object which is sought to be

controlled (Beer 1966). The observation of the limited capacity of governments has led some to claim that the internet is fundamentally unregulable. If regulability is conceived in terms of the narrow definition of regulation this may be true. But it is not just government which has a stake in addressing the problems of the online world to a sufficient extent to make current and new uses of it viable. A broadening of the definition is appropriate to capture the wider array of mechanisms through which public-regarding objectives might be secured in the interests not only of governments, but of society and the commercial world more generally (Lessig 1999).

## **b. Innovation**

Innovation is conceived in the contemporary literature as the bringing of current technology or ideas to a new problem. The use of the term innovation in this qualified way is consistent with the subjective usage of the term ('rather than newness *per se*) in a wider management literature (Walker, Jeanes, and Rowlands 2002: 203). Thus, one of the classic texts distinguishes 'invention', the generation of new ideas, from 'innovation', the application of existing ideas (Rogers 1995 ; Schumpeter 1939: iii 84). Such qualified conception of innovation is relative to the time and space within which it occurs. It is difficult to conceive a manageable empirical methodology to identify absolute innovation. Innovation is a more powerful word than its synonyms, alteration and change. The concept of innovation is valuable for addressing an important policy literature and for securing attention to the issues.

Perhaps what is significant in this subjectively defined conception of innovation is the way that discourse is used as a means for policy makers and regulators to compete and survive in a world where policy activities such as regulation may be perceived as under threat, not only from skeptical politicians, but also from global competition. Within this context policy making and analysis is seen as the production of policy arguments rather than the solving of problems (Majone 1989: 21;cf Black 2002). The discourse of regulatory reform operates at least two levels. There are elite policy communities with strong interests in selling what are often top down solutions to problems defined with a

high level of generality, such as inefficiency, regulatory burdens, and disproportionate costs. A central feature of this discourse is its focus on what government can do. There are also the discourses which actors on the ground use to describe what they do when they are changing the way they do things. A key feature of analyses of such ground level activities, which are often inductively generated and empirical, is their recognition of a configuration of regulatory power which extends well beyond government institutions. This article takes up the suggestion of Julia Black that the language deployed in regulation is 'intimately related to power' and that both meaning and power encapsulated within the discourse of regulatory innovation are contestable (Black, 2002: 165-6).

The deployment of the concept of innovation at the level of policy discourse appears to be more about persuasion (and rhetoric) than capturing the nature of changes occurring on the ground. The use of the term innovation benefits from association with its commercial usage: 'the action of introducing a new product into the market; a product newly brought on to the market' (OED). 'It does not matter so much if an innovation has a great deal of objective advantage. What does matter is whether an individual perceives the innovation as advantageous. The greater the perceived relative advantage of an innovation, the more rapid its rate of adoption will be.' (Rogers 1995). '[O]rganizations can use innovation to maintain organizational legitimacy' (Walker, Jeanes, and Rowlands 2002: 202) seeking 'to convince the public of its progressive and presumably efficient mode of operation' (Feller 1981: 14 cited in; Walker, Jeanes, and Rowlands 2002: 202).

The high-level discourse, which involves persuasion of policy elites of the superiority of one approach or ethos over another, is liable to have different concerns from the ground level analysis which is concerned with identifying and implementing strategies of change which are both workable and effective. Indeed the high level rhetoric of regulatory reform may obscure or disguise ground level innovations. Arguably it is where the two discourses are brought together, for example where a high level policy innovator works inductively from working examples to develop an attractively reasoned argument for wider reform, that innovation is liable to succeed, both in the sense of being widely taken

up and of being effective. For this reason it is important to work with the analysis of innovation in particular regulatory domains. Hence the focus in this article on online transactions.

### **c. Regulatory Innovation**

The usage of the term innovation in public management generally, and regulation in particular, to connote the application of existing ideas in new settings, is a product of reading across from literature about the management of business. While the business management literature recognizes innovations both in process and products, the bulk of attentions has been focused on the latter aspect, which, necessarily, has less purchase on the public management issues.

Regulatory innovation can be observed both at the level of regulatory practice within regimes which are, in their institutional and legal fundamentals, relatively stable (Sparrow 2000: 6) – this might be referred to as ‘developmental or incremental innovation’ – and at a higher level where there is more fundamental institutional and/or legal change – ‘total innovation’ (‘involving discontinuous change’). Falling in between the incremental and total forms are ‘expansionary innovation’ (offering existing services to new user groups) and ‘evolutionary innovation’ (new services to existing user groups) (Walker, Jeanes, and Rowlands 2002: 204). While this classification is helpful, much regulatory innovation is likely to be of the total and most particularly incremental types. A substantial literature attests to the popularity of a theory that there is little that is really new in public administration (eg (Hogwood and Peters 1983) A more fine grained analysis is needed to capture the variety of approaches to innovation in the regulatory literature, paying particular attention to incremental change.

There is no doubting the considerable emphasis on regulatory transition, change or reform over the past twenty to thirty years in the OECD countries and beyond. We may think of these largely top-down approaches as embodying a set of principles and,

underlying them, a number of common meta-principles. Efficiency and transparency would be among the latter group (Braithwaite and Drahos 2000: 507-531). There is also a meta-principle of innovation to be found in the discourse of regulatory reform. The early reform movement in both the United Kingdom and United States went under the banner of deregulation, with much talk of ‘cutting red tape’ on both sides of the Atlantic. The language of deregulation was, arguably, problematic given the absence of consensus on the core proposition immanent within the concept of deregulation, that regulation was not a good thing. The relative success of the deregulation movement, as a policy cause, is surprising. Its contested character arguably prevented its ever being fully established as policy orthodoxy. Within the ‘universe of discourse’ about regulation policies antithetical to deregulation remained within the realm of what was thinkable (cf Bourdieu 1977: 168-170).

Less surprising is the shift in language in the policy discourse of the 1990s towards different terms of expressing concepts of regulatory reform. Arguably what we see going is a ‘contest of principles’ being fought out at quite a high level of abstraction since ‘the informational demands of rule systems would make any contest at this level intolerably complex’ (Braithwaite and Drahos 2000: 527). The winners in battles fought in this form are often those who can deploy the most attractive buzzwords or master trope – at least until the next winner comes along. Some of this rhetoric is deployed to attack current arrangements (with discussions of ‘alternatives to state regulation’ (Better Regulation Task Force 2000) ‘regulatory burdens’ ‘counter-productive regulation’ (Grabosky 1995) ‘paradoxes of the regulatory state’ (defined as ‘self-defeating regulatory strategies’: (Sunstein 1997: Chapter 11) ‘perverse incentives’ and ‘catastrophe’ (Moran 2001). But such negative rhetoric is only like to take an advocate of change so far and positive rhetoric is, arguably, more important in winning the regulation game.

Numerous buzz words indicating some form of innovation have sprung up and claimed their policy and academic adherents within debates on regulatory change. Regulatory reform, the overarching framework chosen by the OECD (OECD 1997, 1997) and the joint APEC-OECD policy agenda on regulation, connotes the amendment of a state of

affairs for the better with hints of addressing political corruption (consistent with some forms of public choice theory). Within the OECD approach key terms including ‘streamlining’ ‘minimising disproportionate burdens’ and ‘flexible regulatory regimes’. The Blair Labour government elected in the UK in 1997 rapidly moved to re-badge the institutions and policies of ‘deregulation’ as ‘better regulation’ and established a Better Regulation Task Force (BRTF). The BRTF rapidly developed and published principles of ‘good regulation’ against which it evaluates existing and new regimes (Better Regulation Task Force 1998) and subsequently published a report ‘Alternatives to State Regulation’ {Better Regulation Task Force, 2000 #273 cf ; Better Regulation Task Force, 2003 #1066}. ‘Smart’ (Gunningham and Grabosky 1998) and ‘smarter’ regulation (Business Round Table 1994) are implicitly set in opposition to dumb or stupid regulation. Responsive regulation (which is said to ‘transcend’ the deregulation debate) is the antithesis of unresponsive or inflexible regulation (Ayres and Braithwaite 1992), as is regulatory reasonableness (Bardach and Kagan 1982). ‘Reregulation’ offers newness in economical form and avoids the negativity associated with ‘deregulation’ (Majone 1990). ‘Regulatory efficiency’ connotes the maximization of benefits from a regime relative to the inputs.

With each of these terms the positive tone of the language is significant. Within this set there are terms which do not immediately reveal why they should have rhetorical success. ‘Reinventing regulation’ (read across from more widespread reforms under the banner ‘reinventing government’: (Sparrow 2000: 109)) sits strangely given the negative connotations of ‘reinventing the wheel’. Reinvention means finding again, implying that we once new how to regulated effectively and efficiently and we have had to relearn it. Perhaps it appeals to nostalgia. In many policy contexts reinvention reflects a failure of institutional memory as to why the particular solution had failed on an earlier occasion (Hogwood and Peters 1983: 261; Hall, Scott, and Hood 2000: 161-170). ‘Regulatory pluralism’ (Gunningham and Sinclair 1999) exploits the possibility of mixing different regulatory instruments, a sensible enough idea, but one that lacks the decisive punch of revealing in the phrase why it might be better than the alternatives. The sources of its rhetorical weaknesses are, perhaps ironically, linked to its origins in inductive reasoning

about changes in ground level regulatory practice. What is striking about rhetoric of regulatory innovation is that it is only weakly linked to the emergent practices within regulatory domains. The successful rhetorical terms of regulatory reform struggle to capture or define the parameters of regulatory innovation in practice. The next section addresses this problem by offering a concrete analysis of the parameters of regulatory innovation within our selected domains of online transacting.

#### **4. Parameters of Regulatory Innovation in Online Transactions**

The nature and extent of innovation in regulatory practice may be assessed by considering the extent to which it deviates from what may be described as traditional regulation based on detailed legislative rules, agency monitoring and enforcement via formal application of sanctions. This model of regulation represents something of an ideal type: much that is regulatory is not pursued through agencies; many regulators have relatively little resort to formal sanctions. Nevertheless the model is not inappropriate as a starting point in sectors where regulation has in recent years been pursued through the promulgation of large quantities of rules, there are commonly specialized regulatory agencies (for consumer protection and for securities regulation at least) and reasonably well developed patterns of formal enforcement.

##### **a. Norms**

Regulatory norms are traditionally conceived of in terms of detailed legislative instruments. Innovation may focus on changing the nature of such norms or deploying other types of norm (Braithwaite and Drahos 2000: 19-20).

A central form of innovation, capable of being accommodated within the institutional structures traditionally associated with regulation, is a shift from dependence on detailed rules towards more general principles. This shift is innovative in that it recognizes the capacity of regulatees to define the implications of regulatory rules in terms of their detailed practices, rather than have these set through rules. In practice it is likely to

generate dialogue between regulator and regulatee with some potential for dialectical reasoning as the means to determine regulatory outcome (Reichman 1992).

For example, the UK Financial Services Agency, established in 2000, was designed to operate in a way which would be neutral in respect both of different services and different technologies. The ‘principles-based approach’ was supposed to maximize sensitivity to risk. In the case of products which are unregulated, because they are offered by off-shore internet companies, the Authority’s strategy, within the principles-based approach, is to promote investor education (Financial Services Authority 2000: 46). The European Commission is attempting to promote a shift to principles-based regulation in the Investment Services Directive, in particular to address the removal of obstacles to cross-border trade in investments arising from the technological revolution of the internet (Schaub 2002). Similar policy trends are observable elsewhere in the OECD.

Legislatures and public agencies are far from being the only standard-setters in the regulatory domains of online transacting. The institutions and instruments of private law also have a significant presence. There is a traditional role for courts in many jurisdictions in setting standards, for example in respect of conduct within fiduciary relationships or for the quality of products, which is only eclipsed to the extent that there is legislative provision. Of equal significance is the private law mechanism through which businesses set bilateral standards for themselves, for other businesses and for consumers. Such norms express terms relating to, for example, payment, delivery, product quality, redress and so on are generally only enforceable by the parties to the contract. They extend beyond the retail supply relationship and may also have significance in what we might call the wholesale domain, for example with the supply of credit-processing facilities (discussed below). The innovation here lies not in the practice of standard-setting through contracts, but rather in the recognition that contracts may be regulatory in their character and effects (Collins 1999: chapter 4).

A third innovation, which challenges the national sovereignty element of traditional conceptions of regulation, is the shift towards supranational norms as setting standards

for regulates. Such supranational norms derive from the ‘non-state legal orders’, (Daintith 1997: 38-39) of international governmental organizations (INGOs) (such as the institutions of the European Union and UNCITRAL) and from International Non-Governmental Organizations (NGOs) (notably in respect of standards).

The OECD has provided one of the key international fora for setting standards for e-commerce. The OECD, *Guidelines for Consumer Protection in the Context of Electronic Commerce* were adopted in 2000. The Guidelines call on businesses to act ‘in accordance with fair business, advertising and marketing practices’ and itemize these requirements in general terms (II). The principle of transparency is translated into requirements that businesses disclose details of themselves, the goods or services offered, and the transaction (III). Businesses should provide robust confirmation procedures and secure payment methods (IV, V). The Guidelines do not challenge existing legal rules on jurisdiction but rather note their variety (VI.A) and advocate making available ‘meaningful access to fair and timely alternative dispute resolution and redress without undue cost or burden’ (VI.B). Responsibility for educating consumers about electronic commerce is said to be shared between governments, business and consumer representatives (VIII). The principles of the OECD *Guidelines* are reflected in the *Voluntary Online Consumer Protection Guidelines* produced by the APEC Electronic Commerce Steering Group. The OECD has subsequently published a detailed guidance on best practice in implementation of the its *Guidelines* (Committee on Consumer Policy 2002), and indicated that the Guidelines have provided the basis for cross-border co-operation (OECD 2003). The International Standards Organization (ISO) is also involved in the setting of standards relating to ecommerce, typically of a more technical nature.<sup>1</sup>

International NGOs have not been very prominent in standard setting in the areas of online gambling and investing and e-shopping. There is some discussion of the transformation of an informal ‘gambling concern’ network, which is linked to the gaming industry, into an NGO. The network is reported to have produced a set of high level principles to govern internet gambling and is seeking to operationalize them through the World Health Organization (Bes 2002). Major non-state players in standard setting in the

ecommerce and online investing domains have tended to be large firms and industry associations.

The prominence of internationally set norms draws our attention to a wider category of innovation – the move towards non-legal rules or soft law. Soft law is defined as norms which derive from governmental bodies which are not legally binding but which are intended to affect behavior. The deployment of soft law may enable a regulator to extend its jurisdiction and reduce the extent of bargaining over norms, reducing negotiation costs for all involved (Hodson, 2004: 1041). The reasons for deploying soft law are well illustrated by our three cases from the online world. Controls on on-line gambling provide a key example where hard law is difficult to enforce and risks being discredited. This observation has not stopped legislatures in Australia and the United States introducing legal bans on online gaming. However, these legal prohibitions have in some cases been accompanied by attempts to support the bans through soft law instruments. Thus governments have been reluctant to attach regulatory law and penalties to those intermediaries, banks and others, through whom payments for illegal gambling might be made. Rather, some governments have attempted to steer the banks towards non-binding norms under which they refuse credit for transactions which are identifiable as on-line gaming. Some for example, the New York State government has worked to persuade major banks to block illegal gaming transactions voluntarily.<sup>2</sup>

With e-commerce most OECD countries have legislated to create a framework for transactions, for example recognizing the validity of electronic signatures. However there has been a reluctance to set down mandatory requirements on businesses in terms of addressing such matters as identifying the location of the trader, provision of redress, and so on. This is a matter of balancing a wish to promote confidence in e-commerce, and thus economic development generally, through promoting confidence in e-commerce against a concern that new trading practice might be stifled by excessive regulation. The Australian code on e-commerce exemplifies the use of soft law (Treasury 2000). The Australian soft law instrument provides a form of implementation of the OECD *Guidelines*.

Within regulatory discourse the term codes generally refers to documents which are generated by self-regulatory organizations to bind members to minimum standards in the way they deal with employees or resources or customers. Self-regulatory standards are conceptually distinct from soft law in two ways. First, their provenance is non-state organizations, typically associations of businesses.<sup>3</sup> Secondly self-regulatory codes are generally binding on their members. Somewhat distinct from self-regulation is stakeholder regulation where groups active in a particular sector, and perhaps government as well (making it a form of co-regulation), combine to develop standards and monitoring and enforcement machinery.

A key self-regulator for online trading in Australia is the Australian Direct Marketing Association (ADMA). ADMA originated and operates a Code of Practice which applies to its 500 members. The code incorporates best practice identified by government and the terms of the OECD Guidelines. ADMA has wide enforcement powers. These powers are legitimated by an authorization from the main competition authority, the Australian Competition and Consumer Commission.<sup>4</sup> However it should be noted that the ACCC authorization is not the source of ADMA's powers - rather it authorizes actions which might otherwise be open to challenge as constituting an anti-competitive restrictive agreement. The source of ADMA's powers is the contract between its members. Accordingly the ADMA code is a central instrument for operationalizing the various domestic soft law and international norms. ADMA's members include overseas companies which are established in Australia, but do not extend to companies which have no presence in Australia. Thus businesses with no presence in Australia, but which sell over the internet to Australian consumers, fall outside its jurisdiction.

ADMA's UK counterpart, the Direct Marketing Association similarly makes compliance with its codes a condition of membership and operates an e-commerce code in addition to its general code of practice.<sup>5</sup> Though the US Direct Marketing Association publishes ethical guidelines these are not said to be binding on members and are not expressed in

the language of a binding code.<sup>6</sup> The presence of effective self-regulatory bodies in countries outside the OECD is generally much less.

A grey class of codes is generated through stakeholder activities under which key groups concerned with an industry (which may include government and consumer groups) come together to produce industry norms. Such codes do not necessarily have the mechanisms of membership contracts to make them binding on the industry as a whole. Each needs to be assessed individually for the means by which its norms are made effective. Where it has the imprimatur of government such a code may be described as co-regulatory and a failure to adopt it may imply escalation in regulatory technique to some more intrusive form of regulation (Ayres and Braithwaite 1992).

An example is provided by development of e-commerce 'trustmarks' in the UK. This has spawned a new sort of umbrella stakeholder regulatory organization to promote confidence in on-line purchasing. TrustUK is an industry stakeholder organization 'endorsed by the UK government' and involving the UK Consumers' Association which permits traders to use the TrustUK e-hallmark where the trader subscribes to an industry code which complies with the meta-principles set down by TrustUK (Hörnle 2002). The principles for the approval of codes include

- active involvement of the code owner (typically an industry self-regulatory organization) in resolving disputes concerning breaches of the code
- compliance with data privacy principles
- compliance with data security principles in respect of payment data
- transparent provision of contractual information in all online offers
- clear policies in respect of returns, cancellations and refunds displayed prior to purchase
- delivery of goods and services within agreed time period
- protection of children

These principles are somewhat more developed than those of the OECD, highlighting an advantage of self-regulation and stakeholder regulation as it has capacity to develop bolder standards. A number of APEC members, notably Japan and Hong Kong, are

developing seal programs of the type developed in the UK (APEC Electronic Commerce Steering Group 2002: E.2).

Lessig's (1999) work on software code has highlighted to potential for standards to be set, implicitly, through architectural or design features which not only assert norms, but are also self-enforcing. A recent critique has pointed out that code differs from public law in that code is as much an instrument of avoiding as for securing compliance with public-regarding norms. We need only think here of the battles over copyright enforcement in respect of filesharing (Wu 2003). The starting point for the idea of deploying code is the observation that software firms 'regulate' their customers through writing into software codes features which inhibit users from certain actions or by requiring that other actions be taken. Lessig's celebrated rhetorical claim 'code is law' highlights the extent to which software (and other designed products) might be deployed for public regarding regulatory functions (Biegel 2001: Chapter 7).

A key example of software being used in regulatory fashion in the world of online transactions occurs where it is mandated that consumers be shown, and perhaps give evidence that they have read, particular information, prior to entering a transaction. Many e-tailers use such practices as requiring the ticking of checkboxes to demonstrate that the user has read the terms and conditions attaching to the transaction. Where such devices are effective in making consumers read such documents then arguably they simultaneously protect the consumer against surprises while protecting the business against attempts to disapply terms on the grounds that they were not effectively incorporated into the contract. With on-line gambling coding can be used to limit the maximum expenditure of a punter in a particular time period to protect against foolishness or excess by consumers who find it hard to stop gambling. With on-line investing coding is used to draw to the attention of consumers to key warnings about investment advice and practices.

## **b. Feedback and Monitoring**

Within regulatory practice the key means for securing feedback about the extent to which there is compliance with the regime norms is through monitoring. Some regulatory regimes mandate public agencies to engage in regular inspections or audits of those whom they oversee. Other regimes mandate regulatees to report certain critical incidents (such as workplace accidents or the discovery of defective products) and tie monitoring to such self-reporting. A third common form is for public agencies to be dependent on complaints as the trigger for an investigation of the practices of particular regulatees. This is the case with many aspects of the practice of consumer protection agencies. With the latter two monitoring forms it is clear that public agencies are substantially dependent on the capacities for monitoring of non-state actors. Pro-active monitoring by regulatory agencies is far from being the norm. Innovation in monitoring practices pushes responsibilities for monitoring further from government agencies towards those with greater capacities and/or stronger interests in detecting deviation from the regime's norms.

Self-regulation provides one of the best-established examples of non-state monitoring of regulatory norms. A complete self-regulatory regime involves the promulgation by an industry group of a code, the establishment of a monitoring mechanism (either proactive or complaints-driven), and a mechanism for the application of sanctions (often fines and, ultimately, expulsion from the association under the terms of the contract under which the association is formed). But self-regulatory monitoring can be separated from standard-setting and enforcement functions each of which can, in principle, be retained by public agencies. Monitoring by stakeholder groups through an organized regime such as Trustmark UK (discussed above) is liable to look rather similar to self-regulatory monitoring.

The potential for what we might call private monitoring is far from exhausted by examples of stake-holder- and self-regulation. In many domains there are non-state organizations with capacities to act as gatekeepers over others (Kraakman 1986). Such organizations engaged in what has been called 'third party policing' (Anleu, Mazerolle, and Presser 2000). Gatekeepers are important where they are capable of disrupting

wrongdoing (within the terms of the regulatory regime) or protecting victims from actions which are lawful, but undesirable within the terms of the regime (such as taking on excessive debt). We can distinguish different types of gatekeeper. Many gatekeepers have contractual relationships with those over whom they hold power. In some instances the contractual relationship is established specifically for the purpose that a firm can secure third party monitoring – a form of health check. Where assurance is required of the compliance by a business with a particular regime there are long established practices of firms contracting with trusted third parties to carry out processes of certification or audit. In some instances, as with audit under corporations laws, such third party validation is required by law as part of a public regulatory regime. In other cases, for example third party certification of compliance with standards, there is no public element to the regime, and the business engages the third party either to comply with the terms of a contract with a purchasing firm or so as to be able to enhance its reputation through declaring itself to comply with a particular standard.

A second class of contractual gatekeepers already have commercial relationships with businesses for reasons other than regulation- for example the supply of insurance or banking services. A central example of such gatekeepers in the online world is the banks who supply credit processing facilities. Many traders are dependent on the availability of credit facilities generally, and the capacity of consumers to use credit cards in particular, for the development of their business. This is particularly true for providers of online products who are generally unable to accept cash. If online traders wish to conclude transactions rapidly online – for example confirming flights or hotels, permitting immediate access to gaming facilities or stock trading facilities- it will be essential to have some kind of secure and reliable payment system. Specialized online payment systems such as Paypal provide one key mechanism for secure payments. Use of credit cards has also been very important to the development of online trade. Accordingly such traders are dependent on the banks and other payment intermediaries which provide processing facilities for credit card payments.

There are a number of points at which the banks wield power over traders wanting credit-processing facilities. First they must decide whether to enter into contracts at all. A bank might reasonably conclude that association with certain types of trade might damage its reputation, or that certain forms of venture present risks to the bank because of the financial position of the trader or the inherent vulnerability of its business to fraudulent or otherwise problematic (and costly) transactions. The incentives for banks to establish the nature and quality of a business customer wanting credit processing facilities is particularly strong in the UK where the bank is subject to joint and several liability in respect of the breach of contract or misrepresentation by the trader.<sup>7</sup> So, for example, where suppliers of furniture or airline seats become insolvent the banks typically pick up the cost to consumers who have paid by credit card but not received their goods or services. Where banks do take on traders in respect of credit processing facilities the banks face strong incentives to monitor transactions.

We may think of non-contractual gatekeepers also of two types – those who possess some form of non-contractual power over regulatees and those who appear to lack any significant power beyond the capacity for whistleblowing. In the first class, important potential gatekeepers in the world of online investing are those who control websites on which information is posted. Investment chatsites and bulletin boards are key places for exchange of information for small investors, but inevitably attract also manipulative and misleading activities. Clearly such gatekeepers possess some degree of power to control the way that their facilities are used. Where there is a great deal of activity proactive monitoring may not be a realistic proposition, but even where this is the case there is still the capacity to respond to the complaints of other users. There is, in general, considerable controversy as to both the desirability and practicality of expecting owners of chatrooms and the like to control their content. But the gatekeeping capacity linked to such mechanisms of information exchange is certain to receive further emphasis within policy discourse (KingsfordSmith 2001).

Gatekeepers who lack any obvious form of power in respect of regulatees, and who accordingly are monitors *simpliciter*, include employees, other businesses and consumers

who do not have contractual relationships with regulatees.<sup>8</sup> Their significance as monitors is hard to gauge since their whistleblowing activities, where they do occur, are frequently likely to be kept confidential by the recipient of the information who does have capacity to take enforcement action. The development of stringent internal compliance programs within firms, sometimes at the instance of public agencies, and sometimes to secure advantage to the firm represents the institutionalization of internal whistleblowing capacities within firms (Parker 2000).

Consumer education as a regulatory strategy is targeted at the capacity of consumers to monitor (and enforce through their market behavior). Thus the Australian Investments and Securities Commission (ASIC) has developed new and oblique forms of investor education. Most famously ASIC erected a website for the fictitious Millenium Bug Insurance company on 1<sup>st</sup> April 1999 and offered returns of at least thirty per cent per annum. The large numbers of consumers who took up the implausible offer were sent emails suggesting they be less credulous in future and the spoof attracted widespread press attention (Kingsford Smith 2001: 546).

Architecture may also be deployed for the purposes of monitoring. Architectural controls over online investing are rather central to the acceptance by regulators of new technologies such as ‘straight through processing’ (STP). This refers to the development of systems through which online investors can trade without any human intermediation. For regulators this raises the potential for all manner of wrongdoing, so a central concern has been to build into STP sufficient automatic checking capacity to detect, for example, money-laundering. This may involve mandating firms to use automated transaction monitoring programs and perhaps also to build in controls which reject transactions which meet certain criteria. With online gambling there have been attempts to build preset expenditure limits and transaction records into gaming software so as to inhibit excessive gambling.

### **c. Enforcement**

The classical model of regulatory enforcement involves public agencies in application of sanctions to those found in breach of the regimes norms. Much empirical research has demonstrated that in many, perhaps a majority of regulatory domains public agencies rarely pursue formal enforcement (Grabosky and Braithwaite 1986). The empirical observations are well captured within the model of the enforcement pyramid within which most activity is located at the base of the pyramid with education and advice to those found in breach (Ayres and Braithwaite 1992). Where such low level strategies are ineffective the pyramid suggests that agencies may escalate to warnings, and then civil and/or criminal penalties. The ultimate penalty at the apex of the pyramid may be some form of incapacitation such as revocation of a license to operate or imprisonment of company directors. A key feature of the analysis is that regulators must have the credible capacity to escalate sanctions up the enforcement pyramid if they are to be able to effectively contain most activity at the base. An elaboration of the theory explicitly recognizes that capacity of other groups to enforce, and addresses key weaknesses in the state-centric focus of the theory of responsive regulation (Scott 2004: 158-159). Within the revised model the pyramid has three dimensions rather than one, with public agencies on one face and businesses and NGOs located on the other two faces (Grabosky 1997; Gunningham and Grabosky 1998). The groups have varied capacities for enforcement, which may be combined in hybrid strategies. Under some conditions business self enforcement or third party enforcement or NGO enforcement may be a more realistic or effective proposition. Even the revised model fails to capture the full potential for enforcement.

Even at the level of public agency enforcement changes in trading practices associated with the internet have called for considerable innovation in securing traditional consumer protection functions in respect of online investing, online gambling and e-shopping. Enforcement problems stem from the potential for traders to be located in other jurisdictions beyond the reach of the capacity for public enforcement. There is little prospect for both asserting jurisdiction and securing enforcement against firms with no legal presence and no assets in the country of the regulator. Analagous to the well

established cases of taxation and criminal law, courts are unlikely to want to enforce the public regulation of another jurisdiction (Whincop and Keyes 2001). Within the theory of the enforcement pyramid the effectiveness of the ‘educate and advise’ strategy is liable to be compromised where, for jurisdictional reasons, there is no credible capacity to escalate to the application of formal sanctions. Where national regulators recognize common enforcement issues there is the potential for cooperation. Where there is reasonable alignment of substantive norms this may offer some protection to consumers purchasing from overseas firms. A number of APEC jurisdictions are reported to assert criminal and/or civil jurisdiction over domestic businesses trading with foreign consumers (APEC Electronic Commerce Steering Group 2002: D1).

The Consumer Sentinel Network is an international network of enforcement agencies which facilitates ‘the confidential exchange of consumer complaint information, including information about consumer fraud and deception perpetrated through the Internet, direct mail, telemarketing, or other media...’(U.S Federal Trade Commission n.d.).<sup>9</sup> The OECD has recently published guidelines directed towards enforcement agencies concerned with protection consumers from fraudulent and deceptive practices across borders. The guidelines are concerned both to promote the harmonization of legal norms around a minimum core and to develop mechanisms for international cooperation including amendment of national legislation concerned with enforcement (OECD 2003). The guidelines, of political necessity, avoid detailed prescription, but set the stage for enhanced cooperation in enforcement.

A stunning innovation in international cooperation is the annual international internet sweep organized by the [International Consumer Protection and Enforcement Network](#)). Established in 1997 the 2003 sweep involved 87 enforcement agencies in 24 countries simultaneously surfing the internet proactively in search of misleading claims. The 2003 sweep targeted travel websites and found many infractions of applicable laws in the various jurisdictions.<sup>10</sup> Following the sweep information was shared between the various agencies with the enforcement body best placed to act on the alleged infraction put in the lead.

In most common law countries self-regulatory codes can be enforced as a form of collective contract and self-regulatory bodies typically possess sanctions they can apply to their members without reference to a court. These sanctions may be arrayed in a classic enforcement pyramid with advice and warnings at the base with the capacity to issue fines, and to suspend or expel members further up the pyramid. Where membership of a reputable trade association is a *de facto* condition for trading in a particular consumer sector then it is possible to hypothesize that such enforcement pyramids may be quite effective, even though there is little empirical evidence for the suggestion.

Emphasis on the role of gatekeepers (discussed above) is conventionally treated as part of the problem of enforcement of regulation and raises the question whether it is possible to parcel out some enforcement functions to organizations other than the regulator (Anleu, Mazerolle, and Presser 2000). A key question is how to secure the cooperation of such gatekeepers in using their disruptive capacity. (Kraakman 1986) suggests that gatekeepers can be classified into market and public variants. Kraakman's market gatekeepers – he gives examples of accountants and underwriters – are said to have strong incentives to use their power to prevent misconduct (Kraakman 1986: 62). This may be true for those issues where the professional responsibilities of the gatekeeper are closely aligned to those of the regulatory regime. Thus accountants have strong incentives to insure that their clients make accurate declarations to revenue authorities. But such alignment between professional duties and regulatory objectives is by no means universal. This is perhaps more true of those market gatekeepers who lack the constraints of professional codes, as with those banks which offer creditor-processing facilities. Their incentives are to offer their services as widely as possible, consistent with their wish to maximize their revenues and minimize loss through fraud and other activities. Thus the market gatekeeper variant is more properly classified as a subset of the public gatekeeper set on those issues where market incentives will encourage the gatekeeper to act on some issues, but other forms of incentive may be required with other issues. Innovation is likely to be found in the manipulation of such incentives to be public gatekeepers. There is a variety of mechanisms through which public gatekeepers (those

possessing the capacity but otherwise lacking incentive) can be incentivized to enforce a regime. Application of penalties has been a key approach (Anleu, Mazerolle, and Presser 2000), though a narrow approach premised upon application of sanctions as explaining enforcement activity of gatekeepers has been criticized (Gilboy 1998).

In addition to being gatekeepers credit card issuers are also major developers of design based solutions to some of the problems they face with online transactions. These activities bear directly on the enforcement of rules against fraudulent use. Banks may, of course, simply terminate contracts with traders who are linked to excessive levels of fraud. But a better commercial solution is to develop architectural features within the transacting process which greatly reduce the possibility of fraud being committed. Internet transactions involving the use of credit cards have traditionally been classified along with telephone transactions as card not present (CNP) and consequently do not require either of the main fraud control measures – a signature or entry of a PIN. Recent innovation has been geared towards providing new levels of security through passwords under schemes developed internationally both by Visa and Mastercard. Both organizations are suggesting that banks and businesses unwilling to take on the cost of these additional security measures will be excluded from the credit processing facilities altogether.

Private enforcement of standards is not restricted to businesses and third parties but may also include individual consumers. Thus a consumer who makes a substantial purchase from an e-tailer is likely to seek redress in the event of non-delivery or the arrival of a sub-standard product. Making a complaint and seeking a remedy informally is equivalent to public enforcement activity at the base of the pyramid. There may be capacity to escalate to lawyers' letters, legal claims and litigation where satisfaction is not forthcoming. But, as discussed, enforcement of contracts in the online world may be problematic where they are made under the law of another jurisdiction and/or where the trader is located outside the reach of the courts of the consumer. It is difficult enough for consumers to enforce contractual rights within their home jurisdiction and using their first language without expecting them to manage litigation in other jurisdictions. There are

two aspects to the problem. The first is having the domestic courts accept jurisdiction as a precondition to making any favorable judgment. The second issue is concerned with enforcement of the judgment against a defendant outside the jurisdiction (Bygrave and Svantesson 2001). If the defendant lacks interests or assets within the jurisdiction within which the judgment is made it is difficult to see how the domestic court can effectively enforce (Zittrain 2003). Within the EU the problem of enforcement within the consumer's jurisdiction was addressed by the 1968 Brussels Convention, recently replaced by the Brussels Regulation.<sup>11</sup> Under the terms of the regulation where a trader markets goods and services in another EU jurisdiction then the consumer is entitled to enforce the terms of any contract in the home jurisdiction of the consumer.<sup>12</sup> This right for consumers, once it applies, is inalienable.<sup>13</sup> There is no clear test where an online trader is directing their website at other EU jurisdictions, but possible indicators include offering local currency, language or delivery options.<sup>14</sup>

There is a trend towards encouraging the use of alternative dispute resolution mechanisms for consumer disputes in many OECD jurisdictions. Within the EU there are formal mechanisms of cooperation to promote ADR in cross-border disputes. Central among these mechanisms is the European Extra-Judicial Network (EEJ-Net) which seeks to assist consumers in using ombudsman and other ADR mechanisms across borders. An important international initiative is the econsumer.gov website which coordinates consumer complaints in respect of online trading in the member countries and collects data on the nature of the transactions and the nature of the complaints.<sup>15</sup> Additionally a large number of online alternative dispute resolution schemes have sprung up to mediate between online traders and consumers (Consumers International 2001).

European Union law has also sought to give consumers new forms of protection, for example against pressurized selling techniques. A key example is the 'right of withdrawal' or 'cooling off period' under which consumers are entitled to withdraw from contracts made at a distance without penalty and without giving reasons within a period of 7 or 14 calendar days.<sup>16</sup>

Additionally consumers have other mechanisms through which they may be able to secure redress, for example by invoking the gatekeeping capacity banks in their credit processing functions. Consumers are liable to complain to their card issuers when transactions go wrong. A relatively simple remedy of a 'chargeback' is available where the card issuer accepts the consumer's case. Card issuers have the financial clout to be able to enforce, through securing withholding of payments by the credit processing bank in respect of their chargeback. In some jurisdictions the provision of chargebacks are mandatory in respect of certain types of transactions (eg fraudulent use). Where there is no regulatory provision many banks have their own policies as to when to give chargebacks extending well beyond statutory minima (Committee on Consumer Policy 2002: 9-10).

With online gambling the banks in a number of jurisdictions have come under pressure to use their gatekeeping capacity to refuse to process transactions linked to gambling. In Australia, for example, the coding of transactions by the service providers has facilitated the banks in enforcing the ban on Australians engaging in online gambling although, as noted above, it is reported that the banks are reluctant to act in the role of gambling police.

Consumers may be able to engage in collective enforcement through a variety of mechanisms. Official mechanisms for consumer organizations to enforce consumer laws have been developed in the European Union, for example empowering consumer groups to enforce rules against the maintenance of unfair terms in contracts.<sup>17</sup> This innovation enables consumer groups to act on complaints which they receive or to enforce in circumstances where they take a different view on either the priority to be given or the nature of a particular wrong doing (Ayres and Braithwaite 1992). In the absence of such legislated collective enforcement powers consumer groups may act through litigation and it has not been uncommon for such groups to take on collective action or test cases in some jurisdictions. There are additionally various opportunities for direct action. The UK Consumers' Association has been one of the key actors in the development of the UK Trustmark scheme (noted above) through its development its Webtrader scheme for

certifying traders as compliant with minimum standards in e-commerce. Direct action may also take the form of encouraging diffuse consumers, through the medium of the internet, to make complaint or engage in anti-social conduct (such as bombardment with emails) in order to make a point - a functional equivalent to the enforcement of some standard.

Control through the market may also have a role. Where consumers are engaged in regular and routine relationships with online providers of goods and services then their capacity to 'exit' may be available as a sanction for breach of applicable standards. Threat to exit may be credible where e-vendors have clear records of the purchasing history of a customer, for example in respect of book purchases. We cannot be certain how such mechanisms work to affect the behavior of online traders, but the desire to maintain both customer base and reputation must be significant for some businesses to the extent that they take steps to resolve disputes effectively, thus complying to some form of standard of expectation of their customers. The capacity of markets to regulate behaviour has also been exploited in the context of consumer-to-consumer (C2C) transactions of the sort supported by e-bay. The e-bay 'community' has thousands of buyers and sellers. With each transaction consumers are invited to review the other party and these reviews are then made available to all members of the community. Some consumers will choose not to deal with a person who is sufficiently new to have no or few reviews, others will take the risk. Very few consumers will deal with someone for whom feedback is not positive. Thus members of the community exchange and can act on information about the reliability of others.

## **5. Conclusions**

There is much that is innovatory about the exercise of regulatory control and near equivalents to regulation in the online world. A focus on the innovations of governmental organizations, the traditional focus of public policy analysis, fails adequately to capture the full range of regulatory innovations. The problem of control over e-commerce has

drawn in supranational governmental and non-governmental organizations, business and consumer groups, and individual firms and consumers in to attempts to apply appropriate controls.

This observation begs the question when it is appropriate to treat some non-governmental control as being part of the applicable regulatory regime. Features which are designed in to software are developed with the intention of applying control, whether at the behest of governments and agencies or not. Community-based initiatives to certify websites as complying with minimum standards clearly have the quality of intention. But some regulatory effects are simply side effects of other intended acts- and this is true for many of the gatekeeper activities which pursue market rather than regulatory ends. Other forms of market behaviour create their effects only through aggregation (for example the exit decisions of consumers). Such invisible hand effects lack intentionality almost completely. This article offers a beginning to the incorporation of the wider range of control mechanisms into the regulatory analysis of the online world. More analysis will be required on what we already know about controls over e-commerce, and for the innovations which are yet to come.

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<sup>1</sup> So, for example ISO/IEC TR 14516 sets standards in respect of trusted third party services.

<sup>2</sup> Office of New York State Attorney General Eliot Spitzer, Press Release June 14 2002. The press release is, in this case, an instrument of soft law, seeking to hold one major bank to its agreement to act as enforcer in a public statement, and to encourage other banks not yet agreeing to follow the line. It is reported that in Australia the major banks are refusing to cooperate with the wish of the federal government they they police illegal gaming transactions with offshore service providers. S. Mitchell 'Banks Refuse to be Police' *The Australian* 6 May 2003.

<sup>3</sup> Though government may be involved in stimulating such self-regulatory activity, causing such processes to be labeled 'co-regulation'

<sup>4</sup> *Re Australian Direct Marketing Association* (1999) ATPR (Com) 50-276.

<sup>5</sup> <http://www.dma.org.uk/DMA/default.asp> (visited 22 April 2004).

<sup>6</sup> <http://www.the-dma.org/guidelines/ethicalguidelines.shtml> (visited 22 April 2004).

<sup>7</sup> Consumer Credit Act 1974, s.75. The trigger to this liability is pre-existing relationship between the issuing bank and the trader. It applies to transactions between 100 and 30,000 pounds sterling. The proliferation of banks issuing the main credit cards has rather complicated the application of the legislation such that voluntary agreements to honour the principle of the legislation have been sought by the Office of Fair Trading in respect of situations where the legal position is uncertain. It is not clear that either the law or the agreements would extent to recognizing joint and several liability between a UK issuing bank and an online trader in another jurisdiction. Committee on Consumer Policy, *Report on Consumer Protections for Payment Cardholders*, OECD (2002), 16.

<sup>8</sup> Where consumers do have contractual relations they may, of course, have private law enforcement rights. The same may apply to other businesses in the sector. Businesses in some jurisdictions may also avail themselves of rights to pursue remedies privately for breach of applicable competition laws.

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<sup>9</sup> Fair Trade Commission *Consumer Sentinel Network Confidentiality Agreement* available at <http://www.ftc.gov/os/2000/07/ftcaccsentinel.htm> visited 22 April 2004. Fraud data generated by the network is published at <http://www.consumer.gov/sentinel/> (visited 22 April 2004).

<sup>10</sup> Office of Fair Trading Press release PN 35/03, 2 April 2003.

<sup>11</sup> Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters OJ L 12, 16.01.2001

<sup>12</sup> art 15.

<sup>13</sup> Art 17.

<sup>14</sup> The European Commission and the Council of Ministers offered a brief guidance on the matter. They state that ‘the mere fact that an Internet site is accessible is not sufficient for Article 15 to be applicable, although a factor will be that this internet site solicits the conclusion of distance contracts and that a contract has actually been concluded at a distance, by whatever means.’

<sup>15</sup> [www.econsumer.gov](http://www.econsumer.gov). (visited 22 April 2004).

<sup>16</sup> EC Directive 97/7/EC (distance selling), OJ L 144, 04/06/1997 pp19-27; Art 6; EC Directive 2002/65/EC (distance marketing of consumer financial services), OJ L 271, 09/10/2002, pp16-24, Art 6 .

<sup>17</sup> [1993] OJ 95/29. The Directive is adopted in the UK empowering the Consumers Association to act independently of public agencies in seeking injunctive relief against businesses which use contract terms against consumers which are deemed unfair: Unfair Terms in Consumer Contracts Regulations SI 1999/2083.