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# Legal and Regulatory Update

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## The Electronic Commerce Directive

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### Abstract

On 4 May 2000 the European Parliament approved the Electronic Commerce Directive,<sup>1</sup> followed by the European Parliament without amendment on 28 February, perhaps persuaded that speed was imperative. Publication in the *Official Journal* followed on 17 June, and member states must implement the Directive into national law before 17 January 2002.<sup>2</sup>

The Department of Trade and Industry has already indicated that the UK will need to take a number of actions to ensure compliance with the Directive.<sup>3</sup> The DTI expects to conduct an internal government consultation on the options for implementation of the Directive in summer–autumn 2000 before launching a public consultation exercise later this year (Table 1).

**Keywords:** Electronic commerce, ISP regulation, information requirements, electronic contracts

**Table 1:** Provisional timescale

Summer–autumn 2000	Government interdepartmental consultation on implementation of the Directive
Autumn 2000	Launch of public consultation on implementation of the Directive
Spring 2001	Response to public consultation including an outline of implementation strategy and proposals for legislative change

### Intentions behind the Directive

The Directive aims to establish legal guidelines for online services and their providers ('ISP' used in a wider sense than an Internet access service provider), covering financial and professional services, business-to-business and business-to-consumer services. Online services are defined as 'information society services', which definition covers any services normally provided against remuneration, at a distance, by electronic means and at the individual request of the recipient of the service.<sup>4</sup>

The Directive aims at developing online services within the internal market without legal frontiers, and seeks to remove uncertainty over the regulation and supervision of online service providers. It prescribes with certain specific exceptions for each member state to take responsibility for those established within its territory<sup>5</sup> and subject the providers to its national laws.

The harmonising of the laws applicable to online services is intended to ensure a high level of protection of general interest, in particular

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protection of minors and human dignity, consumer protection and the protection of public health. These rules include a definition of where operators are established, transparency and information requirements for operators and for commercial communications, the treatment of electronic contracts, liability of intermediary service providers, out-of-court dispute settlement and the role of and cooperation between national authorities. In other areas the harmonising provisions rely on existing EU instruments, which provide for harmonisation in specific sectors or of specific questions, especially in the areas of consumer and personal data protection.

Excluded from the application of the Directive are copyright and neighbouring rights, emission of electronic money, freedom of parties to choose the applicable law, contracts dealing in rights in real property and permissibility of unsolicited e-mails (also known as 'spam').<sup>6</sup>

### **Regulation and supervision of ISPs**

The Directive is based on the EU internal market principles of free movement of services and freedom of establishment. It proposes that ISPs are regulated by the laws of the territory in which the ISP is established (the 'country of origin' principle), while at the same time adhering to other general EU principles, for instance consumer protection.<sup>7</sup> So, in a sale of goods contract, for example, the jurisdiction and laws of the seller will apply.

Consumer groups have called for the conversion from the general country of origin approach to a 'country of destination' approach. This would mean that consumers would be able to sue in their own country. The European Parliament proposed more pro-consumer amendments following the first reading of the proposed Directive, but the Commission did not accept the amendments made by the European Parliament.

The main advantage of the country of destination approach for consumers is that since consumers are the weaker party in a contract, they should be able to sue in their own country with their own laws. Consumers will not make purchases online if they feel vulnerable to fraud. In addition, the cost and complexity of initiating legal proceedings in another member state make it most unlikely that they would consider taking such proceedings. Advocates of the country of destination approach argue that the country of origin approach completely undermines the attempt to harmonise e-commerce laws and would mean that consumers entering into similar transactions would have different rights in different member states.

### **Information requirements**

ISPs must provide to recipients of services their name, geographic address of establishment and details for rapid communication, for example e-mail contact point, the relevant supervisory authority and authorisation scheme, VAT registration number, professional qualifications and professional supervisory authority, if relevant, indicate prices clearly and unambiguously, and state whether prices are or are not inclusive of tax and delivery charges.<sup>8</sup> These requirements would be applicable to ISPs

#### **Country of destination approach**

whether or not the ISP is a sole trader, a partnership or a registered company. Comparable obligations in the physical world are currently applicable to partnerships<sup>9</sup> and companies.<sup>10</sup> A company, for example, is required to state on all invoices and business notepaper (which by extension will include a website) its name, place of business registration, registered number and address of registered office. The effect of the Directive would merely be to make minimum requirements applicable to ISPs, whatever their legal form, and confirm the current assumptions of the applicability of existing legislative requirements to the Internet.

In addition, commercial communications, consisting of any form of communication designed to promote, directly or indirectly, the goods, services or image of a company, organisation or person pursuing a commercial, industrial or craft activity or exercising a regulated profession except by direct access to the information such as a domain name or electronic mail address or such information which is compiled independently, must be identified as such, the natural or legal person on whose behalf the information is given must be clearly identified, promotional offers or competitions must be clearly identified as such, and any conditions applicable must be easily accessible and presented clearly.<sup>11</sup> ISPs must also communicate the technical steps required, terms of business, VAT and advisory costs and facilities to correct form errors for concluding a contract prior to the making of an offer.<sup>12</sup> Most of these information requirements are already in place under the Distance Selling Directive.<sup>13</sup> The Directive would be applicable also to contracts concluded by auction which are excluded from the application of the Distance Selling Directive. New also is the requirement for an e-mail address providing direct access. The majority of these information requirements should therefore have been implemented by 4 June 2000 pursuant to the Distance Selling Directive.

Members of regulated professions must comply in their commercial communications with their applicable professional codes of conduct, in particular governing the independence, dignity and honour of the profession, professional secrecy, and fairness towards clients and other members of the profession, and member states must encourage professional associations to establish codes of conduct applicable to online services.<sup>14</sup> Ensuring fairness on a European playing field as long as varying national codes of conduct regulate the professions may not be as easily achieved. One instance would be that the English Law Society operates a far more liberal regime in respect of the ability of solicitors to advertise and promote their service than, for example, in Germany. Does fairness to other professions and member states mean that English law firms must respect the wider restrictions in other member states so as not to gain an unfair competitive advantage, or would the liberal regimes of one profession in one member state force legislation across the other member states?

### **Unsolicited commercial communication**

Unsolicited commercial communication, colloquially also known as 'spam', is characterised by users sending extremely large (often

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**Spam does not necessarily originate from business**

50 million plus) numbers of e-mails which can block Internet service providers (forming part of but not being alone as ISPs in the sense used in the Directive) services, making it impossible to carry normal traffic to and from their customers. In addition to the above requirements for solicited commercial communication, spam must be clearly and unambiguously identifiable as unsolicited as soon as it is received by the recipient and provide a return address or contact e-mail. Member states may prohibit unsolicited commercial communication and at the very least shall ensure that ISPs consult regularly and respect opt-out registers in which natural persons not wishing to receive such commercial communications can register themselves.<sup>15</sup>

Recent cases in the USA (there have been over 20 reported cases issued by some of the largest US-based ISPs, AOL, CompuServe and Prodigy<sup>16</sup>) and the UK (Virgin Net launched a suit alleging that one of its subscribers had sent up to a quarter of a million junk e-mails through his e-mail account) show that spam does not necessarily originate from business alone, and carries a measurable incidental cost for the businesses which facilitate the operation of the Internet. The UK Internet industry has taken a number of measures to tackle unsolicited e-mail: filtering systems combating spam and ongoing development of a worldwide e-mail preference scheme (joint project between the Direct Marketing Associations of the UK and USA), and some ISPs may individually offer opt-out schemes to gain commercial advantage.

The Distance Selling Directive does not apply to business-to-business transactions and equally does not apply to consumer-to-business or consumer-to-consumer transactions. However, the UK government believes that such industry self-regulatory initiatives, taken together with the EU legislation, are likely to be efficient and effective at tackling the problem of spam. They should certainly be given an opportunity to work before further government regulation is contemplated. But, if industry approaches prove ineffective, further legislation may become necessary.<sup>17</sup>

### **Contracts concluded by electronic means**

Member states must ensure that the legal requirements applicable to the contractual process neither create obstacles to the use of electronic contracts nor result in such contracts being deprived of legal effectiveness and validity on account of their having been made by electronic means, except for contracts dealing in real estate other than rental rights, requiring involvement of courts, public authorities or professions exercising public authority, contracts of suretyship furnished by persons outside their profession and contracts governed by family law.<sup>18</sup>

In most cases, English law does not require writing or signatures. A few contracts still require writing under statute, such as the sale and disposition of an interest in land,<sup>19</sup> leases for over three years, consumer credit,<sup>20</sup> certain forms of insurance deeds, wills and the transfer of shares. Failure to abide by the requirements may render the contract inadmissible as evidence, unenforceable, or completely void.

The UK has enacted part of this already with the Electronic Communications Act 2000, which provides that documents bearing

digital signatures are admissible in evidence as to the authenticity of the communication<sup>21</sup> and empowers the Secretary of State to amend primary legislation to give effect to digital signatures on documents formally required to be in 'writing'.<sup>22</sup> For example, the DTI is looking at whether a provision of this kind could be used to amend the Companies Act 1985 to facilitate the electronic delivery of communications to shareholders, or the lodging of proxies by electronic means where companies so decided and where shareholders agreed. (The DTI will shortly consult separately on these company law proposals.) The government is also considering broadening the legal equivalence of electronic writing to encompass other digital data, such as images, audio-visual and similar applications that are likely to develop in the future. The intention, as with the provisions on signatures and writing, would be permissive, to allow people to take advantage of the possibilities which the information age is opening up rather than mandate particular technologies. Such a provision, if introduced, would be broadly drafted to allow for future technological and commercial developments used for a wide range of filing of and access to electronic documentation and data.<sup>23</sup>

### **Liability of intermediary service providers**

ISPs shall not be liable for information they transmit on condition that they do not initiate the transmission, do not select the receiver of the transmission and do not select or modify the information contained in the transmission. In the case of automatic, intermediate and transient storage of information for transmission, in addition to these conditions ISPs must also comply with conditions on access to the information and the rules regarding the updating of information used in practice by the industry, and act expeditiously to remove or disable access to information on actual knowledge that a court has ordered its removal.<sup>24</sup> This may be welcomed by ISPs, which are probably at the greatest risk from unwanted law suits in the areas of defamation and libel and the infringement of copyright, but this legislation may not go far enough in their view.<sup>25</sup>

In the only publicly reported English Internet defamation case, *Dr Laurence Godfrey v Demon*,<sup>26</sup> Judge Moreland concluded in line with general defamation law principles that an ISP becomes liable for publication of a defamatory article once the ISP has knowledge of its content. *Demon* commented on the unsatisfactory state of legislation, which exposes ISPs to potential substantial monetary claims if an ISP should decide not to remove articles which are claimed by one party to be defamatory and which could result in corresponding censorship by those parties who wished to detain unfavourable commentary relating to them.<sup>27</sup>

The Directive would shift the balance by making the court the arbiter of whether or not any information should be removed, before potential liability could arise. However, where the jurisdictional boundaries limit the courts to their own territory, it may prove difficult for the innocent libelled party or rights holder to obtain the necessary judicial relieve, which would then be a precondition to take preventive measures against publication by ISPs residing in the jurisdiction.

### **Unsatisfactory state of legislation**

## Jurisdiction

The E-Commerce Directive does not address the implication of the Brussels Convention on Jurisdiction, Recognition and Enforcement of Judgments nor the Rome Convention. Article 3 allows e-traders to trade freely on the basis that they comply only with the law of the member states in which they are established. Neither does it designate the court which would have jurisdiction over a dispute, nor the law to be applied to it.

Currently Article 13 of the Brussels Convention confers jurisdiction over a contractual dispute between a consumer and a business on the courts of the consumer's domicile when the contract was preceded by a specific invitation addressed to the consumer or by advertising there and the consumer concluded the contract in that domicile. It is not clear how Article 13 would apply to e-commerce. Some websites might be covered, others, for example those confining orders to a particular country, might fall outside the scope of the Convention. In May last year, Convention member states agreed to amend Article 13 so that the courts of a consumer's domicile would have jurisdiction if a trader 'pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State or to several countries'. This does not resolve the issue.

The European Commission then proposed a revision in the form of a Community Regulation, which under recital 13 stated that electronic commerce in goods or services by means accessible in another member state constitutes an activity directed to that state. The DTI response considered the recital to be going just a little too far by extending the scope of Article 13 to all transactions stemming from a website, which by its nature would be accessible from anywhere. It would mean that e-traders would not be able to limit their exposure to Article 13 by stating or giving other indications that they were not targeting particular member states with their trade.

## Taxation

While excluding its application to the field of taxation,<sup>29</sup> the Directive does give guidance on the important issues of establishment (establishment is constituted by pursuing an economic activity from a fixed establishment). In line with the rules of establishment under the Directive, the Inland Revenue issued a press release on 11 April indicating that the location of websites and the servers that host them should not be factors to be taken into account in establishing in which country a business should be taxed. This provides a practical approach to the potentially difficult question of which server the website originates from, where there is a series of computers doing the work, often in different countries, which may or may not be owned by the e-business in question. It could be virtually impossible to tell whether the main server is playing any role at all.

Speaking at a conference in Lisbon, Gabs Makhoul, the director of the Inland Revenue's International Division, expressed the UK's official

view that a website is not in itself a permanent establishment, and that a server is insufficient in itself to constitute a permanent establishment of a business that is conducting e-commerce through a website or on the server. This is in line with the OECD model tax convention. This convention, used broadly as the basis for international double taxation treaties, provides that a non-resident business is only taxable in a foreign country to the extent that it is carrying on business there through a permanent establishment. That concept is defined as being 'a fixed place of business through which the business of an enterprise is wholly or partly carried on'.

## **Reception of the proposal**

Nearly 90 bodies to date have commented on the Directive.<sup>30</sup> These included trade associations, consumer groups, law firms, data aggregators, rights holders, service providers, publishers, direct marketers and regulated professions. Particular concerns were that the definition of information society services may exclude non-remunerated services, and that this definition may exclude unsolicited commercial communications from the scope of the Directive.

Strong support was evinced for the principle of non-authorisation of ISPs<sup>31</sup> and for the general information requirements identifying the ISPs,<sup>32</sup> although some concern was expressed that this seemed to be aimed at websites and could be excessively burdensome for business-to-business activities or e-mail transactions, and also at the lack of safeguards in some areas.

There was strong support for the recognition of electronic contracts.<sup>33</sup> Views on the derogations of the applicability to specified contracts differed — some wanted to delete some or all, others pointed out potential problems with land law, law relating to succession, hire purchase and credit agreements.

Many felt that the information requirements prior to making an offer and concluding a contract here were too wide and over-complex. It was thought that this could prove very time-consuming for the purchaser — particularly for services involving microcharges. There was near unanimity that the 'third click' envisaged by paragraph 1(c) of Article 11 was superfluous. This was not mirrored in transactions in the offline world and would cause uncertainty for consumers.

## **References**

1. 00/31/EC, hereinafter the 'Directive'.
2. Art. 23, 00/31/EC.
3. DTI <[www.dti.gov.uk/cii/econsintro.htm#implementation](http://www.dti.gov.uk/cii/econsintro.htm#implementation)>. These essentially consist of a review of compliance of current legislation with the concept of unrestricted access by ISPs from other member states and unrestricted conclusion of electronic contracts, availability of appropriate enforcement powers, developing alternative dispute resolution services online, developing administrative guidance for Internet conduct by regulated professions, resourcing and promoting a UK contact point with other member states and review of current liability of ISPs for content transmission and caching.
4. Recital (17), 00/31/EC.

## **Strong support for recognition of electronic contracts**

5. Recital (5), 00/31/EC.
6. Annex, 00/31/EC.
7. Article 3, 00/31/EC.
8. Article 5, 00/31/EC.
9. Partnership Act 1898.
10. Section 349, Companies Act 1985.
11. Article 6, 00/31/EC.
12. Article 10, 00/31/EC.
13. Article 4, 97/07/EC.
14. Article 8, 00/31/EC.
15. Article 7, 00/31/EC.
16. See a list of US cases at <http://tigerden.com/junkmail/cases/index.html>.
17. Statement made on the DTI website at [http://www.dti.gov.uk/CII/elec/elec\\_com\\_2\\_1.html#OtherChanges](http://www.dti.gov.uk/CII/elec/elec_com_2_1.html#OtherChanges).
18. Article 9, 00/31/EC.
19. Section 2, Law of Property (Miscellaneous Provisions) Act 1989.
20. Consumer Credit Act 1974.
21. Section 7, Electronic Communications Act 2000.
22. Section 8, Electronic Communications Act 2000.
23. See statement made by the DTI at [http://www.dti.gov.uk/CII/elec/elec\\_com\\_2\\_1.html#OtherChanges](http://www.dti.gov.uk/CII/elec/elec_com_2_1.html#OtherChanges).
24. Articles 12 and 13, 00/31/EC.
25. See Demon comments at <http://www.demon.net/info/helpdesk/announce/da1999-07-05a.shtml>.
26. Unreported preliminary ruling; see details at <http://www.demon.net/info/helpdesk/announce/da1999-07-05a.shtml>.
27. See <http://www.dispatches.demon.net/pr/1999/pr1999-05-24a.shtml>.
28. Sections 22–26, Copyright, Design and Patent Act 1988.
29. Article 1, 00/31/EC.
30. The DTI has summarised all comments received at its website at <http://www.dti.gov.uk/cii/ecomdirective/summary.htm>.
31. Article 4, 00/31/EC.
32. Article 5, 00/31/EC.
33. Article 9, 00/31/EC.