Legal and policy challenges facing electronic commercial marketplaces and trading exchanges

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Abstract

Electronic marketplaces and exchanges now handle a significant portion of the commercial transactions associated with international e-business. Many different laws and regulations govern those marketplaces and the transactions they process. This paper identifies legal issues that have the greatest impact on the expansion of electronic marketplaces. These key legal issues have the greatest influence on public perception of the integrity of the digital markets. The continued expansion of digital marketplace activity requires widespread public confidence in the integrity of the marketplace. Effective legal oversight of the markets is essential to foster the necessary level of public confidence. Resolution of certain fundamental legal issues associated with electronic markets is vital to the future success of those markets.
Keywords: law, regulation, digital markets.

1 Introduction

This paper examines the key legal issues affecting the perceived integrity of electronic markets. It focuses on: prevention of fraud; transaction security and enforceability; information privacy; antitrust and competition law compliance; and securities regulation. These legal issues have the greatest potential impact on public perception of the integrity of digital markets. These legal concerns have significant impact on public confidence in digital markets because they affect the perceptions of fairness and security that the public holds with respect to the markets. In general, markets are perceived to be of high integrity if they are easily accessible, if the transactions are transparent and enforceable, and if all participants are treated fairly. Continued expansion of use of electronic

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marketplaces requires continued user confidence in the integrity of those markets. Only the legal system can provide a foundation for that public confidence. In this way, future success of digital markets depends on the effectiveness of the legal system as a means to promote public perception of market integrity.

2 Key digital marketplaces

There are three leading forms of electronic marketplaces: consumer-oriented markets (e.g., eBay); industry trading exchanges (B2B portals, such as Covisint); and securities/commodities exchanges. Each of these marketplaces serves a different set of users and offers a different set of transactions. Consumer marketplaces generally connect individual buyers and sellers, commonly in an auction setting. They process many transactions, and the value of each transaction is relatively low. Industry trading exchanges facilitate transactions between companies. They generally support transactions between businesses and their suppliers or their corporate customers. These digital markets commonly process fewer transactions, but each transaction has a greater dollar value. They establish a network of transactional connections between commercial organizations in a given industry. Online securities exchanges facilitate sale and purchase of financial instruments, including securities and options. These exchanges process a high volume of transactions involving both individual and institutional participants.

3 Demand for market integrity

The public in general and the users of each of these different markets demand integrity in the markets as the price of their support for the markets and their participation in the markets. Users of digital markets expect to be protected by law when they participate in those markets. To the extent that they have confidence that laws are adequate to provide protection and that the laws are fully and fairly enforced, they will believe in the integrity of the markets. Based on that belief, users will continue to participate in the digital marketplace.

For consumer-oriented markets the leading issues of concern as to market integrity are fraud prevention, transaction security, and effective information privacy (FTC [1] and FTC [2]). Consumers look to government authorities to implement and enforce a legal framework that will reduce the risk of fraud in online auction transactions. In the United States, the Federal Trade commission (FTC) at the national level, and state consumer protection agencies have played an active role in fraud control. Globally, consumer protection authorities from many different countries are coordinating their online regulatory efforts, through initiatives such as econsumer.gov (http://www.econsumer.gov) recognizing that consumer protection in digital markets is an international undertaking.

Each consumer also expects secure transactions. Consumers want assurance that payments associated with digital market transactions will be processed securely. Another aspect of secure transactions involves the privacy of personal information. Consumers want to be sure that their personal information is used only for the purposes they intend and only by the parties they authorize. With respect to information privacy, some jurisdictions, the European Community and Canada for example, have adopted specific legal protection for personally identifiable information. The United States has not followed that approach, but information privacy issues have now been brought within the framework of the consumer protection process. Under that approach, information privacy breaches can be treated as unreasonable trade practices, and legal remedies are available.

The integrity of B2B exchanges is most extensively affected by an assessment as to whether the exchanges promote fair competition. Traditional antitrust principles are applied to B2B markets in an effort to preserve market integrity (FTC [3] and Crowell and Moring [4]). There is public concern that the collaboration among businesses necessary to develop and maintain B2B exchanges can evolve into collusion that threatens competition. For this reason, antitrust regulators continue to monitor B2B digital markets carefully.

In online securities and commodities markets, the integrity of the markets is most directly influenced by the perceived integrity of the trading supported by the markets. Among the legal issues of greatest concern in online securities trading are the accuracy and accessibility of market information (SEC [5], SEC [6], Unger [7]). Securities regulators now direct significant attention to online markets and transactions. Electronic markets are now an integral part of the global financial marketplace, largely because user confidence supported their expansion.

4 Digital markets and the law

The legal system and legal institutions play a critical role in the public perception of market integrity. The law establishes the rules associated with the operations of the markets. Legal institutions are the mechanism through which those rules are enforced. Public confidence in digital marketplaces is largely influenced by a belief that legal requirements will be effectively enforced. The law thus performs two important functions in support of digital marketplaces. It maintains order by providing a deterrent for bad conduct and a remedy to redress such conduct when it occurs. The law also builds public confidence in the integrity of the markets. This confidence is what fuels increased participation in the markets. Both of these functions of the law are of vital importance to preservation of healthy and dynamic electronic markets.

The law influences market integrity in at least two ways. At one level, legal institutions directly regulate the structure and operation of some markets. Securities markets, for example, are commonly subject to direct regulation regarding their structure, practices, and procedures. In addition, the law provides a mechanism through which individual private parties can enforce their legal rights in association with market activities. For example, an individual consumer claiming that another party failed to perform its commercial obligations could initiate a private legal action against that party, or could ask the government consumer protection regulator to take action against the party. The law

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influences the structure and operations of digital markets through direct regulation and by providing the formal mechanism through which private parties can enforce their rights. The existence and effective functioning of both of these legal processes contribute to public confidence in the markets.

Some participants in the digital marketplace advocate significant reliance on self-enforcement of policies to protect market integrity. Under this approach, markets or industries develop their own standards of conduct and practice, and they then self-enforce those requirements. Self-regulation can play an important and helpful role in promoting public confidence in digital markets. It is important, however, that self-regulation is effectively integrated with formal legal oversight of market activities. Although self-regulation can be an effective method to manage market behaviour and practices, self-regulation alone is not likely to provide as a great a level of public confidence in market integrity as will self-regulation coupled with formal legal review. Self-regulation can provide a valuable foundation for management of market behaviour; however, market users are generally more comfortable if that self-regulation is supplemented by regulation involving formal legal institutions, such as the courts and government regulatory agencies.

An example of seemingly effective balancing of private, self-regulation with formal legal oversight involves management of information privacy. In some countries, government has taken the lead in regulation of commercial use of personal consumer information (e.g., the European Community). In other countries (such as the United States), self-regulation through industry organizations and consumer groups has played a leading role. Yet, in both contexts a combination of self-regulation and formal regulation by legal authorities seems to be evolving as the optimal approach to protect public confidence in the commercial marketplace on the issue of information privacy.

Proponents of digital markets should have an interest in effective enforcement of laws applicable to the markets, even if that enforcement at times requires them to incur some additional costs or to limit their conduct. Those short-term costs and constraints can yield long-term benefits if they help to inspire greater public confidence in market integrity, and thus drive greater market participation. Thus developers, operators, and users of digital marketplaces should recognize that effective enforcement of rules of market operation and of user conduct are critically important to the future success of the markets. Digital markets rely on law and legal institutions to win the confidence of users. Digital markets are largely dependent on law for their survival.

5 Conclusions

There are three leading classes of digital marketplaces. Each confronts slightly different legal issues. All of those markets must, however, develop adequate legal oversight to preserve user confidence in the integrity of the markets. Failure to preserve user confidence will threaten the future viability of those markets. Proponents of digital markets should thus welcome regulation of those markets, to the extent that such regulation encourages user confidence in the

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markets. Although digital market regulation may cause short-term increases in costs and may constrain some market conduct, that may well prove to be a small price to pay for greater future public confidence in the markets and corresponding growth in market participation.

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