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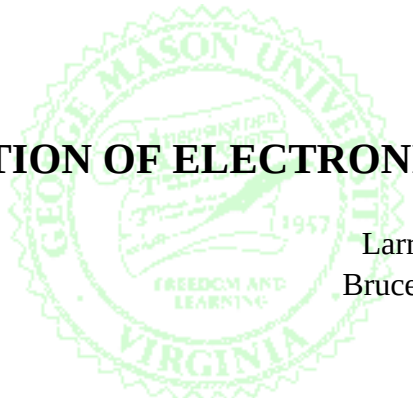

STATE REGULATION OF ELECTRONIC COMMERCE

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STATE REGULATION OF ELECTRONIC COMMERCE

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ABSTRACT

There is a widespread belief that regulation of electronic commerce by individual states is unworkable because firms doing global business on the Internet easily can evade state regulation or, conversely, because firms are subject to excessive regulation due to states' overlapping jurisdiction. Instead, it is believed that electronic commerce is best regulated at the federal or even global level, and that any state regulation should be pursuant to uniform laws. This article challenges this conventional wisdom. It shows that regulation of electronic commerce by individual states has several advantages over federal or uniform state laws and that the problems of state regulation have been exaggerated. First, state regulation provides variety, evolution and competition that is especially well suited to the dynamic nature of electronic commerce. Second, courts can minimize jurisdictional overlaps by enforcing choice-of-law and choice-of-forum contracts. Third, markets alleviate concerns that enforcing contractual choice would lead to a "race-to-the-bottom" in state Internet regulation. Any remaining problems with state regulation should be analyzed in comparison with those that would result under federal or uniform state law.

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Electronic commerce provides both opportunities and challenges for markets. Reduced transaction costs and more rapid dissemination of information offer the potential for more efficient consumer markets. At the same time, however, new markets and technologies can create regulatory gaps and apparent opportunities for new regulation. One example is vendors' use of consumer marketing information that they obtain on the Web. The FTC has recommended regulating privacy[1] and Congress is considering legislation dealing with practices for using personal information collected from consumers.[2] Another is the debate concerning regulation of the licensing of software and other computer information, particularly in transactions over the Internet. The National Conference of Commissioners for Uniform State Laws has promulgated the Uniform Computer Information Transactions Act (UCITA).[3] More recently, the Federal Trade Commission held hearings on whether there should be federal regulation of these transactions.[4]

Although there are many calls for regulation, there is no consensus over what form such regulation should take,[5] or even if any new regulation is required at all.[6] Critics of current proposals to regulate electronic commerce dispute the notion that

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[1] *See* Federal Trade Commission, *Final Report of the FTC Advisory Committee on Online Access and Security*, May 15, 2000 (available online at www.ftc.gov); *Privacy Online: Fair Information Practices in the Electronic Marketplace: A Report to Congress*, May, 2000, available online at www.ftc.gov/reports/privacy2000/privacy2000.pdf.

[2] *See Hearing on Privacy Legislation Before the Senate Commerce Committee* 2000 WL 23833311 (October 3, 2000). The Senate Commerce Committee also held a hearing on privacy on July 11, 2001. In addition, Congress has recently passed new laws that address privacy concerns under specific conditions. *See* Children's Online Privacy Protection Act, 15 U.S.C. §6501 et seq. (1998), (establishing regime of notice, disclosure, parental consent for collection of personal information on children); Gramm-Leach-Bliley Financial Services Modernization Act, Title V, 15 U.S.C. § 6805 (regulating disclosure of information by financial institutions); The Health Insurance Portability Act of 1996, 15 C.F.R. Part 160 (regulating online health information).

[3] *See* UNIF. COMPUTER INFORMATION TRANSACTIONS ACT, FINAL ACT WITH COMMENTS, (September 29, 2000), available at http://www.ucitaonline.com.

[4] *See* Federal Trade Commission Workshop, Warranty Protection for High-Tech Services, MATTER NO. P994413, October 26-27 (2000).

[5] *See* Keith Perine, *Senate Committee Knuckles Down on Net Privacy Issues*, THE INDUSTRY STANDARD, July 11, 2001 (available online at www.thestandard.com/article/0,1902,27832,00.html (noting numerous issues facing Congress in drafting such legislation, such as what type of information should receive privacy protection, the level of consent, creation of a private right of action, and the issue of whether state privacy law should be preempted).

[6] *See* Fred H. Cate, *Privacy in Perspective* (2001).

new legislation is required, and have noted the potential costs of such regulation.[7]

Rather than attempting to provide a definitive guide to the appropriate regulation of electronic commerce, this article deals with the more fundamental question of who should provide this regulation -- specifically, whether regulation should be at the federal or state level. In contrast to the substantial disagreement over the substantive provisions of new legislation regulating electronic commerce, there is apparent agreement that such regulation should be at the federal level.[8] Those favoring new substantive regulation of electronic commerce argue that states are not the appropriate regulators because new contracting technologies and global nature of the Internet will allow firms to easily evade state regulation. On the other hand, businesses engaging in electronic commerce do not want to be subject to overlapping regulation by many states, and thus support broad federal pre-emption of state regulation.

This article shows, instead, that state regulation of electronic commerce has a significant chance of success, and that the criticisms of state regulation are not persuasive. State regulation of electronic commerce has the important advantages of being dynamic and decentralized, and so more suitable to the evolving nature of electronic commerce than top-down methods of lawmaking. Moreover, the costs of overlapping state regulation can be minimized by the use and enforcement of parties' contractual choice of jurisdiction and law.

The article proceeds as follows. Part I discusses the significant uncertainty regarding the appropriate approach to regulating electronic commerce. Part I illustrates these problems by analyzing two of the most contentious issues that have arisen regarding electronic commerce: consumer marketing information, and sale of electronic information. In both areas, commentators argue that electronic commerce encourages consumers to transact without adequate opportunities to bargain or to obtain information. But the speed and efficiency of electronic commerce help consumers by providing for free-flowing information and cheap comparison-shopping. Increased regulation therefore may not only be unnecessary, but also counterproductive to the extent that it slows down transactions and impedes information flows. Moreover, it is not clear what types of constraints best address any problems of electronic commerce.

Parts II and III discuss potential advantages and costs of a state law approach to regulating electronic commerce. On the one hand, state law permits 51 legislatures to experiment with varying solutions to the many issues discussed in Part I. On the other hand, the existence of multiple jurisdictions in what is essentially a national market seems either to expose vendors to overlapping regulation or to let

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[7] See Robert W. Hahn, *An Assessment of the Costs of Proposed Online Privacy Legislation*, (May 7, 2000), available online at http://www.aei.org.

[8] *See, e.g.*, *Voter Attitudes Toward Privacy Policy*, June 25, 2000, available online at www.actonline.org/pubs/polls/toplines.pdf (showing 62% polled agreed that new laws should be federal in nature).

them easily avoid rules they do not like.

Part IV considers whether enforcing contracts providing for the applicable jurisdiction and law would solve these problems. It shows that the problem of overlapping regulation is not as serious as critics of state law assume because the dynamics of jurisdictional competition ultimately will give states incentives to enforce contractual choice. Jurisdictional competition also is likely to constrain inefficient state regulation, and therefore prevent the race-to-the-bottom that critics of state law fear.

Part V fills in the policy analysis by discussing the problems with a federal approach to regulation. Even if a regime that reliably enforces the contractual choice of a state's jurisdiction and its laws operates reasonably well, it will not eliminate all potential problems with electronic commerce. But it is necessary to avoid the Nirvana fallacy of comparing a supposedly perfect federal solution with a flawed state approach. Part V shows that there are many potential defects with existing federal regulation of the Internet. Moreover, federal law probably will not solve the problem of overlapping state law because it is likely to be added to, rather than to substitute for, state law.

Part VI discusses the uniform state law alternative to both federal law and to contractual choice of state laws. It shows that a process designed to maximize the degree of state law uniformity is a second-best solution to contractual choice of state law and forum. To the extent that uniformity is efficient, it is likely to emerge spontaneously from a contractual choice of law regime.

Part VII discusses a possible limited role for federal law as an adjunct to a primarily state law regime. Specifically, federal law could protect against possible over-regulation by ensuring enforcement of contractual law and forum. It might also help protect against under-regulation by providing for minimum standards for disclosing the applicable state law.

Part VIII contains concluding remarks, including implications of the analysis for global regulation and contexts where contractual choice of law is not a feasible option.

I. FINDING THE RIGHT REGULATORY BALANCE

This Part shows that there is significant uncertainty about how to regulate electronic commerce, about whether any there is any market failure that requires regulation, and about whether government needs to supply whatever regulation is required. This is important background for the discussion in Part II of state law's advantage over federal law of allowing for a variety of approaches and facilitating legal experimentation with and competition among diverse regimes. This Part focuses on two specific types of transactions that have figured prominently in the debate over regulating electronic commerce – consumer marketing information and sales of software and other electronic information. These issues are intended only as illustrations. The article's basic analysis of state and federal regulatory approaches

can be generalized to deal with other regulatory issues concerning electronic commerce.

A. ARGUMENTS FOR REGULATION OF ELECTRONIC COMMERCE

The benefits of regulating electronic commerce relate to the potential harms to consumers in an unregulated market, assuming there are defects in the private contracting process. These benefits will be discussed separately regarding consumer marketing information and sales of computer information.

1. Consumer marketing information

The technology of Internet shopping has generated new types of and markets for information. Consumers who move through the Web leave behind two types of data trails they would not generate in a shopping mall: the more conventional track from email addresses or other information needed to enter a website, which can be linked with other information through databases and search tools; and clickstream data, which is more significant for present purposes because it is generated silently and therefore raises more significant issues about informed consent. Websites place unique identifying numbers called "cookies" on the hard drives of surfing consumers who use the popular Netscape and Internet Explorer browsers. Web operators can use cookies to combine all information generated by visits to the site by a particular computer. Thus, the web operator knows which pages the computer visited and how long it spent on each page.

The most important concern about consumer marketing information is not with clickstream data in itself, but with the web operator's ability to link this information with identifying information the consumer has supplied, including email addresses, passwords, and credit card numbers. This is how Amazon.com knows not only that you are "Larry" or "Bruce" when you visit it, and what books you have bought in the past, but also your addresses and credit card information.

This concern is compounded by the fact that buyers of web space such as DoubleClick and other advertising networks also can buy the web sites' cookies and aggregate information from many websites, thereby creating huge databases of individuals' visits to websites, identities and demographics.[9] Privacy advocates became particularly concerned about the size of these databases in June, 1999, when DoubleClick announced a merger with a direct marketer, Abacus Direct, that held such information as individuals' credit card numbers, mailing addresses, phone numbers, and household income. Also, an FTC privacy study found that only 10% of websites were implementing "fair information practices" that the FTC had

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[9] This has been referred to as the related problems of "data warehousing" and "data creep," where sellers use cheap storage to keep increasing the amount of information they compile with a view to possible future uses. *See* Joel R. Reidenberg, *Resolving Conflicting International Data Privacy Rules In Cyberspace*, 52 STAN. L. REV. 1315, 1323-24 (2000).

identified,[10] and there is evidence that at least some Web retailers have breached their privacy promises or otherwise failed to meet consumers' expectations.[11]

In general, because of these concerns, prohibiting the sale or further dissemination of consumer marketing information can increase consumers' willingness to transact business and disclose information, either explicitly or through visiting a website.[12] Moreover, commentators have argued strongly that individuals have fundamental privacy rights to protection of personal information that mandatory rules should enforce.[13]

Before continuing the analysis, it is important to distinguish the issues concerning "cookies" from those concerning other types of privacy invasions. First, government intrusions differ qualitatively from those of firms. Private firms that abuse consumer information lose customers. People lack analogous exit opportunities regarding government intrusions. A state's residents must comply with the entire bundle of state rules mandating disclosure of personal information when

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[10] *See* FTC Report, *supra* note 1 at 37.

[11] *See* Don Clark, *RealNetworks Will Issue Software Patch To Block Its Program's Spying on Users*, WALL ST. J., Nov. 2, 1999 at B8 (discussing RealNetworks Inc. gathering of information about consumers' listening habits without their consent); Michael Moss, *A Web CEO's Elusive Goal: Privacy*, WALL ST. J., February 7, 2000 at B1 (discussing how ELoan, despite touting the strength of their privacy policy, tracked information about consumers without their consent); Perine, *supra* note 22 (discussing criticism of change in Amazon privacy policy to permit sale of consumer marketing information); Rebecca Quick, *On-Line: GeoCities Broke Privacy Pledge, FTC Declares*, WALL ST. J. August 14, 1998 at B1 (discussing GeoCities settlement of an FTC complaint that it misrepresented that information on application forms would not be disclosed to third parties); Thomas E. Weber, *Network Solutions Sells Marketers Its Web Database*, WALL. ST. J., February 16, 2001 at B1, 2001 WL-WSJ 2854616 (discussing Network Solutions' plan to sell database of customer information); Nick Wingfield, *DoubleClick Moves to Appoint Panel for Privacy Issues*, WALL ST. J., May 17, 2000 at B2, 2000 WL-WSJ 3029717 (discussing DoubleClick Inc.'s plans to combine databases of people's Web-surfing habits and of users' personal information).

[12] For other discussions of how protection of information can increase incentives to disclose, *see, e.g.,* Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privilege, and the Production of Information*, 1981 SUP. CT. REV. 309 (1982) (discussing contractual prohibition against disclosure of information); Edmund W. Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEG. STUD. 683 (1980) (same); Richard S. Murphy, *Property Rights in Personal Information: An Economic Defense of Privacy*, 84 GEO. L. J. 2381 (1996).

[13] *See e.g.,* Julie E. Cohen, *Examined Lives: Informational Privacy and the Subject as Object*, 52 STAN. L. REV. 1373 (2000); Christopher D. Hunter. *Recoding the Architecture of Cyberspace Privacy: Why Self-Regulation and Technology Are Not Enough* (February, 2000); Jessica Litman, *Information Privacy/Information Property*, 52 STAN. L. REV. 1283 (2000); Reidenberg, *supra* note 9; Joel R. Reidenberg, *Setting Standards for Fair Information Practice in the U.S. Private Sector*, 80 IOWA L. REV. 497, 516-18 (1995); Joel R. Reidenberg, *Restoring Americans' Privacy in Electronic Commerce,* 14 BERKELEY TECH. L. J. 771, 771 (1999); Pamela Samuelson, *Privacy as Intellectual Property?* 52 STAN. L. REV. 1125 (2000); Paul M. Schwartz, *Privacy & Democracy in Cyberspace*, 52 VAND. L. REV. 1609 (1999).

they engage in state-regulated or state-monitored activities, including birth, driving, working or dying. Equating governments' and firms' privacy incursions, as some commentators have done[14] questionably assumes that product markets are so deficient that they leave people as helpless as to deal with private companies as they are to deal with state governments.

Second, it may be helpful to further distinguish relatively mundane identifying information from information that consumers clearly expect to be kept private, such as medical records.[15] People turn over the latter type of information expecting that it will not be disclosed to others without their consent. The main issues here concern whether firms and governments should be able to use the information notwithstanding this expectation, and how and under what circumstances violators should be punished. Given greater uniformity of preferences and expectations, state law's advantage of offering diverse approaches does not come as strongly into play.[16]

2. Electronic information sales

Electronic information sales involve many of the same problems of fraud and product defect as other products sold over the Internet. This raises questions whether special rules should apply to contracting for electronic information. As discussed below,[17] these questions center on the rapid nature of the Web contracting process.

There are also questions regarding the seller's ability to restrict use of the information through the license agreement and by design of the product. In general, limiting use of information has external effects on other users by allowing contracting parties to keep private information that would otherwise fall into the public domain. This applies, for example, to license terms that restrict the buyer's right to resell[18] and that let licensors price discriminate among users. It has been said

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[14] *See, e.g.*, Cohen, *supra* note 13; Reidenberg, *supra* note 9; Schwartz, *supra* note 13.

[15] *See* Health Insurance Portability Act of 1996 (HIPAA), *supra* note 2, at Part 160.202, 203(b) (providing against preemption of more stringent state laws).

[16] To be sure, there are overlaps between categories, as where medical information is used for commercial purposes without revealing intimate secrets. For a discussion of privileges and duties in this setting *see infra* §I(B)(1).

[17] *See infra* §I(C)(2).

[18] Such restrictions in effect allow the parties to opt-out of the "first sale" doctrine in copyright law under 17 U.S.C. §109 (1994), which limits the ability of the copyright holder to place post-sale restrictions on the resale or disposal of the copyrighted work by the buyer. This does not, however, suggest that such restrictions are in conflict with the Federal copyright laws and should be preempted. The Committee report to Section 109(a) of the Copyright Act of 1976 indicates that Congress anticipated that parties would contract out of the first-sale right. *See* Mark Lemley, *Intellectual*

that the latter type of restriction alters the "delicate balance" between producers and users under federal copyright laws.[19] Allowing contractual protection of databases also might be said to conflict with the federal copyright laws by allowing contracting parties to protect works that should be in the public domain. But contractual protection of compilations leaves people free to independently compile publicly available data into competing databases.[20]

B. COSTS OF REGULATION

The costs of regulating electronic commerce are as uncertain as the benefits. This is demonstrated in the following subsections, again focusing on consumer marketing information and electronic information sales.

1. Consumer marketing information

In general, consumer marketing information, like other arguably private information, benefits both merchants and consumers by reducing information and transaction costs, and in turn inefficient transactions and fraud.[21] Such disclosures can be part of a mutually beneficial exchange of money and information for goods and services on terms that reflect the disclosed information. They tell web merchants how many and what types of consumers they are reaching, and help them target particular advertisements to particular consumers. The data creates new companies such as DoubleClick, and a new product for web merchants to sell, which may be critical to firms' survival given the thin margins of web retailing.[22] More precise targeting of web advertising increases its information value to consumers, thereby helping consumers satisfy their preferences.[23] Consumers also get reduced prices or

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Property and Shrinkwrap Licenses, 68 S. CAL. L. REV. 1239, 1273, n.156 (1995) (citing Notes of Committee on the Judiciary, H.R. Rep. No. 94-1476, at 79 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5693). Thus, the prohibitions on the post-sale transfers do not apply to transactions such as licenses that cannot be characterized as sales. *See* 17 U.S.C. § 109(d).

[19] *See* Ramona L. Paetzold, *Contracts Enlarging a Copyright Owner's Rights: A Framework for Determining Unenforceability*, 68 NEB. L. REV. 816 (1989). *See also* Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CAL. L. REV. 111 (1999); Michael J. Meurer, *Price Discrimination, Personal Use and Piracy: Copyright Protection of Digital Works*, 45 BUFF. L. REV. 845 (1997).

[20] See Zeidenberg v. ProCD, 86 F.3d 1447, 1454 (7th Cir. 1996).

[21] *See, e.g.*, Richard A. Posner, OVERCOMING LAW, Chapter 25 (1995); George J. Stigler, *An Introduction to Privacy in Economics and Politics*, 9 J. LEG. STUD. 623 (1980).

[22] This became evident in the recent efforts by Toysmart to sell consumer data in bankruptcy, and Amazon's response to the Toysmart controversy of quietly changing its privacy policy to classify customer information as a business asset that is transferable if Amazon or one of its business units is sold. *See* Keith Perine, *Privacy Centers Have Their Eyes on Amazon*, THE INDUSTRY STANDARD, December 6, 2000 (available at http://www.law.com).

[23] See Murphy, *supra* note 12 (citing Equifax Survey showing that 78% agreed that "because

free benefits for using websites that collect data and from an expanded choice of products and services.[24] Thus, prohibiting collection of cookies could prevent the production of valuable databases and increase transaction costs.[25]

Privacy regulation of cookies could have other negative consequences. In general, privacy is not always desirable because it cloaks undesirable activity.[26] This is as true of privacy concerning web-related conduct as it is outside the Internet context. An important recent example concerns *A&M Records, et al. v. Napster*,[27] which found that the majority of files transferred by persons using the Napster service were unauthorized copies of copyrighted music, and ordered Napster to cease operations for contributing to copyright infringement. The Ninth Circuit, affirmed the district court's grant of the plaintiff's motion for a preliminary injunction but remanded for a determination as to whether Napster could differentiate infringing and non-infringing uses so that a remedy would not unduly interfere with legitimate activities, noting that the "mere existence of the Napster system, absent actual notice and Napster's demonstrated failure to remove the material, is insufficient to impose contributory liability."[28] Napster subsequently attempted to employ filtering technologies in an attempt to block the sharing of copyrighted materials. These filters proved to be ineffective, and the district court subsequently ordered Napster to shut down.[29] This is where cookies might have been useful: Napster or the recording companies could use cookies or Globally Unique Identifier (GUID) technology to allow copyright holders to detect licensing

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computers can make use of more personal details about people, companies can provide more individualized services than before").

[24] *See* Testimony of Professor Paul H. Rubin, House Committee On Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection Hearing Privacy in the Commercial World, March 1, 2001.

[25] See Solveig Singleton, *Privacy as Censorship: A Skeptical View of Proposals to Regulate Privacy in the Private Sector*, CATO Institute Policy Analysis No. 295 (1998); Solveig Singleton, *Privacy Versus The First Amendment: A Skeptical Approach.* 11 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 97 (2000).

[26] *See supra* text accompanying note 21.

[27] 114 F. Supp. 2d. 896 (2000), aff'd 239 F. 3d. 1004 (9th Cir. 2001), injunction entered 2001 WL 227083 (N.D.Cal. Mar 05, 2001).

[28] *Napster*, 239 F.3d at 1027 (citing Sony Corp. v. Universal City Studios, 464 US 417, 442-43 (1984)).

[29] However, the 9h Circuit Court of Appeals recently overturned the district court's order that required Napster to remain offline until it was successful in preventing all unauthorized trading of copyrighted works. *See* Ronna Abramson, *Court Allows Napster Back Online*, THE INDUSTRY STANDARD, July 18, 2001; *Napster Stops its Old Ways*, THE INDUSTRY STANDARD, June 28, 2001 (available online at http://www.thestandard.com).

or copyright violations without deterring non-infringing uses.[30]

In short, cookies provide valuable information. Since information generally has some of the qualities of a public good in that it is difficult for suppliers to internalize all of the benefits, there is reason to suspect that a socially suboptimal amount of this information will be produced.[31] It is, therefore, important not to over-regulate, and to focus on the precise problems that require regulation.

Attempts to determine the appropriate regulatory balance focus on whether an individual should have a privacy right and, if so, what form this right should take.[32] Cookies are not protected as an intellectual property right of the consumer who is the subject of the information.[33] Some privacy protection for consumer data

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[30] For a discussion of the use of GUID technologies, see Jonathan Weinberg, *Hardware-Based Id, Rights Management, and Trusted Systems*, 52 STAN. L. REV. 1251, 1261-3 (2000). The use of some type of identifier may be necessary to prevent the sharing of copyrighted works through the second generation of peer-to-peer (P2P) file sharing software. Unlike Napster, these technologies, such as Gnutella, Aimster, and iMesh do not use a central server to connect users. The absence of a central server precludes the use of filtering software. Indeed, the record companies and movie studios have begun aggressively to pressure internet service providers to cut off the accounts of subscribers that use file trading software such as Gnutella. *See* John Borland, *File Trading Pressure Mounts on ISPs*, CNET News.com, July 25, 2001 (available online at http://news.cnet.com).

[31] *See* Rubin, *supra* note 24.

[32] *See* Murphy, supra note 23. *See generally*, Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. PAPERS AND PROCEEDINGS 347 (1967) (showing that technological changes that alter the relative value of certain resources have resulted in the creation of new property rights).

[33] Because such information would be produced without property right protection, the benefits of legal protection are unlikely to outweigh the increased costs of monopoly and expression. *See, e.g.*, William M. Landes and Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEG. STUD. 325, 347-9 (1989) (noting that strengthening intellectual property protection can reduce welfare by increasing the cost of producing subsequent works). Where consumer marketing information is used to produce valuable databases and other works, federal statutory intellectual property rights can cover subsequent uses of these materials under some circumstances, but not the facts themselves or obvious compilations. *See* Feist Publications v. Rural Telephone Service, 499 U.S. 340 (1991). *See also* Mark A. Lemley, *Private Property: A Comment on Professor Samuelson's Contribution*, 52 STAN. L. REV.1545, 1546-47 (2000) (noting the lack of protection for database compilations of information individuals would seek to cover under privacy rights). Analogously, although novel and non-obvious discoveries based on personal genetic information can be patented (*see* Diamond v. Chakrabarty, 447 U.S. 303 (1980)), intellectual property laws do not protect the genetic information itself. *See* Moore v. Regents of the University of California, 793 P.2d 479 (Cal. 1990), *cert denied* 499 U.S. 936 (1991); Litman, *supra* note 13 at 1303-4. Nor would consumer marketing information appropriately be covered by state laws that seek to encourage the production of facts, since protection is limited to "hot news" and protection against "free-riding" by direct competitors. *See* International News Service v. Associated Press, 248 U.S. 215 (1918); National Basketball Association v. Sports Team Analysis and Tracking Systems, 105 F.3d 841 (2nd Cir. 1997)) trade secret law (*but see* Samuelson, supra note 13 (suggesting adopting default contract terms based on trade secret law) or right of publicity statutes that protect

may, however, be efficient. Problems may arise when such data is collected and used without the consumer's knowledge or agreement. There is a potential conflict between the social benefits of disclosure, including from creating new databases, and an individual's desire to control the further dissemination of consumer information because of the threat of reputational harms, a general taste for privacy or autonomy, or the possibility of identity theft.[34]

The fundamental issue is whether a default rule of privacy is more efficient than a default rule that allows collection and dissemination of consumer data. Because circumstances vary across transactions, a contract default rule may be more efficient than a mandatory rule.[35] Even if merchants collect and use information for purposes other than completing the transaction, as when they sell transactional and clickstream data to third parties, there is no problem if the consumer is informed and voluntarily agrees. Informed consumers will give up personal information when its privacy value is less than what someone else is willing to pay for it, which in turn depends on the value of subsequent use of the information. The default rule could be embodied in statutes or tort law,[36] although protection against dissemination of accurate and factual personal information based on the tort of invasion of privacy is limited.[37] There is limited protection of privacy concerns based on the tort doctrine of breach of trust,[38] and it has been suggested that this doctrine should be expanded.[39] But the only discernable principle underlying such duties is one of

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celebrities' interests in their original and distinctive identities.

Cookies should be distinguished from a public figure's identity. Property rights in this context can serve as an incentive to produce and as a disincentive to dissipate a valuable asset. *See* Mark F. Grady, *A Positive Economic Theory of the Right of Publicity*, 1 UCLA ENT. L. REV. 97 (1994). *But see* Vanna White v. Samsung Electronics America, Inc. 989 F.2d 1512 (9th Cir. 1993) (dissent from order rejecting the suggestion for a hearing en banc).

[34] See Richard A. Posner, *Privacy*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, Vol. 3 at 103-8 (P. Newman, ed. 1998).

[35] *See e.g.*, Murphy, supra note 23, Jerry Kang, *Information Privacy in Cyberspace Transactions*, 50 STAN. L. REV. 1193 (1998).

[36] *See* RESTATEMENT (2D) OF TORTS §652A-C (1976) (providing that the right of privacy is invaded by unreasonable intrusion upon the seclusion of another, appropriation of the other's name or likeness, the unreasonable publicity given to the other's private life, or the publicity that unreasonably places the other in a false light before the public).

[37] *See* Robert Gellman, *Does Privacy Law Work?* in TECHNOLOGY AND PRIVACY: THE NEW LANDSCAPE (Phillip E Agre & Marc Rotenberg, eds., 1997); Murphy, supra note 23; Schwartz, *supra* note 13.

[38] See Murphy, supra note 23.

[39] See Litman, supra note 13.

implied contract,[40] which returns to the default rules analysis.

Given transaction costs, an efficient default rule would maximize social surplus net of the costs of contracting around the rule.[41] This depends partly on what the parties would have agreed to ex ante, in the absence of transactions and information costs.[42] As noted above, parties presumably would agree to allow collection and dissemination of consumer data if and only if the expected value of future uses of the information at the time of contracting exceeds the value of privacy. For example, in *Moore v. University of California*,[43] where a valuable and patented cell line was eventually established from tissues obtained from a patient being treated for leukemia, the court recognized a fiduciary duty by the doctor to disclose the reasons for taking the cells, but denied the patient an intellectual property right to his cells since the medical research use of Moore's cells does not require attribution to or identification of him, and Moore had signed a standard form prior to surgery consenting to having blood and tissue samples taken after surgery for medical research. In a case like *Moore*, the fiduciary duty is arguably based on the patient's ability to demand payment for his continued cooperation if he knows the medical value of his cells. But this might prevent valuable medical research. In general, the law encourages production of information by enforcing contracts despite one party's failure to disclose material information about which it knows the other side is mistaken.[44] This supports a default rule in the *Moore* situation permitting use

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[40] *See* Murphy, supra note 23, at 2410. *See also* Richard A. Posner, ECONOMIC ANALYSIS OF LAW, at 271-2 (5th ed. 1998) (noting identity of economic analyses of tort and contract law).

[41] *See* Ronald Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960); Harold Demsetz, *When Does the Rule of Liability Matter?* 1 J. LEG. STUD. 13 (1972). *See also* Lemley, *supra* note 33, at 1554 (noting that allocating strong rights to consumers is inefficient because high transactions costs will prevent the value increasing transfer of such rights).

[42] Frank H. Easterbrook & Daniel R. Fischel, *Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1416, 1433 (1989); Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983). *But see* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L. J. 87 (1989) (arguing that penalty defaults can be efficient).

[43] 793 P.2d 479 (Cal. 1990), *cert denied*, 499 U.S. 936 (1991).

[44] *See* Anthony T. Kronman, *Mistake, Disclosure, and the Law of Contracts*, 7 J. LEG. STUD. 1 (1978). *See also* Janet K. Smith and Richard L. Smith, *Contract Law, Mutual Mistake, and Incentive to Produce and Disclose Information*, 19 J. LEG. STUD. 467 (1990). Some have even suggested that the informed party should be able to lie. *See* Robert Heidt, *Maintaining Incentives for Bioprospecting: The Occasional Need for a Right to Lie*, 13 BERK. TECH. L. J. 667 (1998). For a discussion of this point in a different context, *see* Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117 (1982); Jonathan Macey & Geoffrey Miller, *The Fraud on the Market Theory Revisited*, 77 VA. L. REV. 1001 (1991).

of the information even without explicit patient consent.[45]

In contrast to the *Moore* context, a rule that requires disclosure of the potential uses or consumer data may be efficient because one consumer could not capture the value of a compilation of cookies by threatening to withhold his future cooperation and because privacy concerns may be greater regarding consumer data that identifies the individual. Thus, in *Dwyer v. American Express*,[46] where American Express had collected and analyzed cardholders' spending patterns without obtaining informed consent, the court held consistent with *Moore* that there was no tort misappropriation because the defendant created the value "by categorizing and aggregating [cardholders'] names."[47] However, unlike in *Moore*, the court held that Amex's failure to inform cardholders that their spending habits would be analyzed and their names sold to advertisers constituted a deceptive practice under the Illinois Consumer Fraud Statute because some consumers may not have used the card if they knew of the practice.[48]

Still another situation is involved in a case involving medical information that *does* identify the individual. Here, the need for disclosure may be stronger than for other private information because of the greater sensitivity of the information. Thus, in *Weld v. CVS Pharmacy*,[49] where CVS used information collected from customers who filled prescriptions at their stores to maintain, without customers' informed consent, a database that CVS used to conduct a direct mail campaign funded by several pharmaceutical companies, the trial court denied defendant's motions for summary judgment on customers' claims based on a statutory right to privacy,[50] unfair practices,[51] breach of confidentiality and fiduciary duties, and for tortious misappropriation of private personal information, noting individuals' special expectation of privacy concerning medical information, and distinguishing *Dwyer*.[52]

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[45] Disclosure of medical information is now regulated by HIPPA, *supra* note 2 at §§164.502, 508(f), 512(i) (containing strict requirements for disclosure of all potential uses of medical information, including research purposes requiring treatment of the individual).

[46] 273 Ill.App.3d 742, 652 N.E.2d 1351 (1995).

[47] 273 Ill. App. 3d at 749, 652 N.E. 2d at 1356.

[48] The court also held that plaintiffs failed sufficiently to allege damages from defendants' practices, affirmed dismissal of the tort intrusion claim for failure to show intrusion.

[49] 1999 WL 494114 at 5 (Mass. Superior Ct. June 29, 1999).

[50] Mass. G.L. ch. 214, §1B provides that "[a] person shall have a right against unreasonable, substantial or serious interference with his privacy."

[51] *See id.* ch 93A.

[52] The court subsequently certified a class of Massachusetts CVS customers that received a mailing. *See* Weld v. CVS, 1999 WL 1565175 (Nov. 19, 1999). However, the court also noted that the

But note that medical information that identifies the patients may be at least as valuable as the information collected in *Moore*, suggesting a possible collision between the individual's privacy rights and the social costs of privacy.

These cases indicate the difficult tradeoffs involved in creating privacy rights, and how the extent of these rights should depend on, among other things, the consumer's expectations of privacy, and on how regulation will affect incentives to produce valuable information. Thus, a particular rule may be wrong for a significant number of transactions.[53]

Even beyond these cases, there are many other issues regarding the appropriate extent of privacy-related regulation. For example, perhaps firms should incorporate privacy concerns into their governance structure, as by hiring "chief privacy officers" to oversee and focus attention on privacy compliance. However, like other aspects of corporate governance, the costs and benefits of this move may vary from firm to firm.[54] If the costs of structural privacy compliance exceed the benefits, a mandatory rule requiring firms to have such personnel may constitute an entry barrier. Moreover, as discussed in more detail below,[55] it is not clear what form any privacy protection might take, including whether the rules should be of the opt-in or opt-out variety.

In general, given the transaction-specific nature of the appropriate rules and the costs associated with adopting too high a level of privacy protection, contract default rules would appear to be the right approach. But even if that principle is accepted, it may be not be clear what the default rules should be or who should provide them. These issues do not lend themselves to a one-size-fits-all, all-at-once federal approach.

2. Computer information transactions

Internet sale of computer information raises several questions about the appropriate level of regulation. To begin with, there are issues regarding the level of regulation necessary to protect consumer expectations. First, what does "merchantability" mean with respect to computer software, where consumers expect some "bugs," but not too many? Second, what terms are appropriate to the sorts of licensing transactions that occur in this context as distinguished from outright sales? Third, what levels of detail and clarity should be required in disclosures to consumers? Fourth, how explicitly must consumers waive warranties or other protections? In general, highly detailed disclosures and explicit assent procedures impose additional transaction costs in terms of reducing the speed of electronic

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misappropriation claim was probably preempted by the privacy statute cited above. *Id.* at 6-7.

[53] See Posner, *supra* note 40 at 112-3.

[54] *See generally*, Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990)

[55] *See infra* Subpart I(D).

commerce that may or may not be outweighed by the benefits in terms of effectuating consumer preferences.

There are additional issues concerning the social costs and benefits of regulation, particularly including those relating to incentives to produce information. Unlike the usual sale of a consumer product, software licenses typically restrict or limit resale of the product by the consumer. By preventing resales by original buyers, these terms allow licensors to price discriminate between low-value and high-value users.[56] Price discrimination, in turn, may enable licensors to extract more profits from the product, and thus increase their incentives to produce the information. Although licensors may be able to use self-help even without legal enforcement, this may significantly increase licensors' costs.[57]

Apart from rules regarding resale, contracts may protect property that is not protected by intellectual property laws,[58] such as databases,[59] thereby remedying Congress' failure to foresee the path of technological development.[60] This protection increases the return on a compiler's investment, and therefore the probability that the information will be produced.[61] Any policy that leaves everything to Congress's

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[56] *See ProCD*, 86 F.3d at 1449-50. For economic analyses of selling information that is shared by multiple users, *see* Yannis Bakos, et al., *Shared Information Goods*, 42 J.L. & ECON. 117 (1999); Stanley M. Besen & Sheila N. Kirby, *Private Copying, Appropriability, and Optimal Copying Royalties*, 32 J.L. & ECON. 255 (1989); Stanley J. Liebowitz, *Copying and Indirect Appropriability: Photocopying of Journals*, 93 J. POL. ECON. 945 (1985).

[57] For an economic analysis of self-help, see Kenneth W. Dam, *Self Help in the Digital Jungle*, 28 J. LEGAL STUD. 393 (1999). Meurer, *supra* note 19 argues that facilitating price discrimination is not necessary given superior substitutes such as digital self-help. Some have questioned the legality of broad self-help rights. *See* Julie Cohen, *Copyright and the Jurisprudence of Self-Help*, 13 BERKELEY TECH. L.J. 1089 (1998).

[58] *See* Robert W. Gomulkiewicz, *The License is the Product: Comments on the Promise of Article 2B for Software and Information Licensing*, 13 BERKELEY TECH. L.J. 891, 898 (1998); Raymond T. Nimmer, *Breaking Barriers: The Relation Between Contract and Intellectual Property Law*, 13 BERKELEY TECH. L.J. 827 (1998), *also available at* http://www.2bguide.com/docs/rncontract-new.html (visited Nov. 6, 1999).

[59] As to the conclusion that copyright law does not protect databases like the one involved in ProCD, *see* Feist Publications, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340 (1991) (rejecting the "sweat-of-the-brow" theory of copyright). *See generally* Jane C. Ginsburg, *Copyright, Common Law, and Sui Generis Protection of Databases in the United States and Abroad*, 66 U. CIN. L. REV. 151 (1997).

[60] The conclusion that Congress's failure to protect certain types of information results from a lack of foresight rather than a conscious decision to allow such information to fall into the public domain is supported by Congress's recent attempt to fill the gap regarding protection of databases involved in cases such as ProCD. *See* Harvey Berkman, *Congress Tackles Database Law*, Nat'l L.J., July 22, 1999, at B1.

[61] *See* Michelle M. Burtis & Bruce H. Kobayashi, *Intellectual Property and Antitrust Limitations on Contract*, in DYNAMIC COMPETITION AND PUBLIC POLICY (J. Ellig ed., 2001). With regard to the use-

limited foresight might create a centralized, uninformed and inflexible system that provides inadequate incentives for the creation of intellectual property and therefore would not serve the intellectual property laws' goal to "promote the progress of the sciences and useful arts."[62] Indeed, private ordering may produce more efficient results than those under the copyright laws.[63]

C. ARGUMENTS FOR MARKET FAILURE

As shown in subparts A and B, regulators face significant questions in balancing the costs and benefits of regulation. This raises the question of whether merchants and consumers are likely to do a better job in formulating and agreeing to mutually beneficial terms and prices. More specifically, is there anything about the contracting process in this context that may be conducive to market failure, and that therefore may justify having regulators making the difficult cost-benefit decisions discussed above? These arguments will be discussed generally in this section, and then revisited below in the specific context of enforcing contractual choice of law.[64]

1. The Internet as a lemons market

It has been claimed that consumers will resort to brick-and-mortar merchants unless online merchants are tightly regulated.[65] This is implicitly a claim that consumer marketing information involves a "lemons" market: because consumers cannot distinguish between high and low-quality promises of data protection and enforcement levels, they will not be willing to pay for higher levels of protection and low-quality merchants will dominate the market.[66] It arguably follows that merchants

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creation tradeoff, see generally Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309 (1982); Edmund W. Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEGAL STUD. 683 (1980).

[62] U.S. Const., art. I, § 8, cl. 8. *See* Douglas G. Lichtman, *The Economics of Innovation: Protecting Unpatentable Goods*, 81 MINN. L. REV. 693, 694-95 (1997); John S. Wiley, Jr., Bonito Boats*: Uninformed but Mandatory Innovation Policy* 1989 SUP. CT. REV. 283, 299-301 (1990).

[63] *See* David Friedman, *In Defense of Private Orderings: Comments on Julie Cohen's "Copyright and the Jurisprudence of Self-Help"*, 13 BERKELEY TECH. L.J. 1151, 1158 (1998).

[64] *See infra* Subpart IV(C).

[65] *See, e.g.,* Schwartz, *supra* note 13. The FTC Report notes that consumer "apprehension likely translates into lost online sales due to lack of confidence in how personal data will be handled," citing survey reports. *See* FTC Report, *supra* note 1 at 2. *See also* Murphy, supra note 23 (citing results of Equifax Surveys showing large increases in percentage of those responding who were "concerned" about their privacy). However, there is substantial reason to question the accuracy of many of the surveys of consumer concerns about privacy. *See* Solveig Singleton & Jim Harper, *With a Grain of Salt: What Consumer Privacy Surveys Don't Tell Us*, Competitive Enterprise Institute, May 22, 2001.

[66] See George Akerloff, *The Market for `Lemons': Qualitative Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

and consumers both would benefit from strong legal rules that induce consumers to rely on web merchants.

The "lemons" argument assumes that companies can survive on the web by selling low quality goods at high prices to dumb consumers. However, this argument seems inconsistent with several important features of Internet markets. First, the web enables consumers to deal in a brief period and at low cost with many different merchants. This lets them compare terms and products offered by many merchants.

Second, because on-line merchants need to encourage consumer trust in this new market, they have ample incentives to build reputations for and otherwise signal their trustworthiness. Merchants that frustrate consumer expectations devalue their reputations and effectively forfeit their bonds.[67] Consumers, after all, can choose not to deal with merchants that are perceived as untrustworthy or can limit their disclosure of information. For example, consumers can refuse to make personal disclosures, turn off the cookie feature of their browsers, or use a variety of devices that control the amount of marketing information consumers make available and to whom they give it.[68]

Third, various media, including the Internet itself, spurred by highly vocal privacy advocates, rapidly disseminate information about background facts and individual merchants. For example, when DoubleClick acquired a direct-mail company and planned to merge its cookie data with the direct-mail database, "a fierce backlash" forced DoubleClick to postpone the database merger plan and hire prominent consumer advocates as privacy monitors.[69] Because consumers can refuse to deal with offending websites or deny marketing information to these sites, a consumer backlash can reduce web operators' ability to accumulate information and give them an incentive to change their practices. Moreover, it is cheap and easy for individual consumers and competing merchants as well as organizations to post information about defective products and dishonest merchants, and sophisticated search engines enable shoppers to find this information.

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[67] *See generally,* Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981); Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297 (1978). As to the nature and size of reputation penalties, *see* Jonathan M. Karpoff and John R. Lott, Jr., *The Reputational Penalties Firms Bear from Committing Criminal Fraud,* 36 J. L. & ECON. 757 (1993); Mark L. Mitchell, *The Impact of External Parties on Brand-Name Capital: The 1982 Tylenol Poisonings and Subsequent Cases,* 27 ECON. INQ. 601 (1989); Mark L. Mitchell and Michael T. Maloney, *Crisis in the Cockpit? The Role of Market Forces in Promoting Air Travel Safety,* 32 J. L. & ECON. 329 (1989).

[68] *See, e.g.*, www.anonymizer.com (making available free software that allows anonymous surfing); www.adsubstract.com (offering a cookie customizer that allows users to manage cookies); www.junkbuster.com. *See also* David P. Hamilton, *Freedom Software Lets You Get Some Privacy While Surfing the Web*, Wall St. J., August 10, 2000 at B1 (discussing software that lets users hide behind alternate identities).

[69] *See* Wingfield, *supra* note 11.

Fourth, it is unnecessary for all consumers to be sophisticated or aware of the problems for markets to protect all consumers. Because of vendors' high costs of discriminating between the informed and uninformed in this setting, due partly to their reliance on standard form contracts, competition for the marginally informed consumer protects the uninformed consumer.[70] Marginal Internet consumers, who are likely to be better educated and more technically adept than consumers generally, therefore will determine contract terms in this setting.

2. The nature of web contracts

The process of contracting on the web might seem to disadvantage consumers. Consumers typically do not bargain over terms, but rather either accept or reject "adhesion" contracts they are offered on merchants' websites. The rushed and casual atmosphere of web surfing might be said not to be conducive to contracting.[71] However, even if consumers cannot bargain with each of their vendors, they can easily shop among many alternative vendors, as discussed in the previous subpart. Accordingly, the "adhesive" nature of a contract does not alone make it inefficient.[72] Moreover, regulation that in effect requires bargaining by refusing fully to enforce adhesion contracts would be inefficient if the benefits of bargaining do not outweigh the costs.[73]

Second, the web may actually offer more opportunities for viable bargaining than contracting off the web because it makes more feasible mechanisms by which consumers can carefully read contracts before buying or licensing products. This is particularly applicable to the problem of licensing software. Because it is difficult to design a mechanism for reaching agreement on complex terms of a license prior to sale, vendors commonly use licenses that are included in the product that consumers do not see until they have bought and paid for the product, taken it home, and torn off the product's "shrinkwrap." Consumers thus are bound by a complex contract

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[70] *See* Alan Schwartz & Louis L. Wilde, *Intervening In Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979). *See also* Jeffrey R. Brown & Austan Goolsbee, *Does the Internet Make Markets More Competitive?* NBER Working Paper No. W7996, http://papers.ssrn.com/paper.taf?abstract_id=248602 (November 2000) (showing evidence that Internet comparison shopping for life insurance has caused general price decreases across demographic groups).

[71] For commentary critical of enforcement of analogous "shrinkwrap" contracts formed when consumers use software sold with licenses in plastic wrapping, *see* Lemley, *supra* note 19 at 120 n.20 (1999); Lemley, *supra* note 18.

[72] *See* Declan McCullagh, *Why Internet Privacy Is Overrated*, Thursday, April 29, 1999, available at privacy http://www.speakout.com/Content/ICArticle/3821 (noting that consumers are not at the mercy of Amazon because they can always go to Barnes & Noble); ProCD v. Zeidenberg, *supra* note 93 at 1453 (noting that "[c]ompetition among vendors, not judicial revision of a package's contents, is how consumers are protected in a market economy.").

[73] *See generally*, Friedman, *supra* note 63 at 898.

with little opportunity to negotiate or read it. On the other hand, if consumers' consent is not deemed to occur until a later period, they might benefit from the product without paying for it. The web makes it easy for merchants to give consumers as much time as they want to read the contract before they click on the download button. Also, the web facilitates a kind of automated contracting where consumers configure web agents, or bots, to look for and accept or reject certain types of contract terms.[74]

Third, the Internet does not necessarily involve the asymmetry of bargaining position that seems often to exist between buyers and sellers. Because the Web has reduced the costs of selling by eliminating the need for bricks-and-mortar storefronts, it is conducive to smaller vendors.

3. The Internet as a lambs market

Even if consumers can compare the deals offered by many merchants, they still have to understand what they are buying and (in the case of consumer marketing information) selling. Advocates of privacy regulation argue that consumers may be unable accurately to value their information in monetary terms.[75] Like lambs they will be shorn unwittingly of their information. Merchants able to obtain consumer marketing information at less than its value to consumers will have little incentive to offer high levels of consumer protection in order to lure consumers to the Web. Having obtained the information cheaply, merchants will be better able to price discriminate among consumers, thereby reducing customers' surplus.[76]

For the reasons discussed in subsection 1, consumers probably are not ignorant of use of merchants' use of consumer marketing information.[77] The question is whether consumers systematically undervalue their information, or value it correctly but nevertheless derive enough benefit from web transactions that they are willing to give up the information for less than its value to merchants. Assuming that consumers know that their marketing information is valuable to merchants, it is not clear why they would systematically undervalue the information, rather than either systematically overvalue it or, more likely, value it accurately on average across consumers and transactions. The fact that merchants such as Internet service providers are willing to buy advertising space on consumers' computers by offering

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[74] *See infra* text accompanying note 101 (discussing P3P protocol).

[75] *See* Cohen, *supra* note 13; A. Michael Froomkin, *The Death Of Privacy?* 52 STAN. L. REV. 1461, 1504-5 (2000) (arguing that consumers are "myopic").

[76] *See* David G. Post, *What Larry Doesn't Get: Code, Law, and Liberty in Cyberspace*, 52 STAN. L. REV. 1439, 1446-7 (2000); Weinberg, *supra* note 30 at 1275. The net effect of price discrimination is ambiguous since some consumers will be better off, and total welfare can increase. Id at 1275-6. See also ProCD v. Zeidenberg, 86 F.3d at 1449.

[77] *See* Murphy, *supra* note 23 (citing Equifax survey reporting that 42% polled had refused to provide information to a business because of privacy concerns).

free or heavily discounted services suggests that consumers are aware of the value of their data.[78] If consumers accurately value their information but nevertheless choose to sell it for less than it is worth to website operators, then there is a further question of whether this division of the surplus is somehow inefficient.[79]

Advocates of regulation argue that markets are inadequate because they do not protect non-market values such as dignity and self-expression.[80] Circulating information about individuals constrains their ability to take positions and lead lifestyles that do not conform to social norms, thereby becoming a strong force for conformity. But again, it is not clear why these considerations would not lead people to overvalue their information, and therefore make too little of it available from a social welfare standpoint. Moreover, it is not clear why government would make better choices than individuals. Regulators' estimates of values higher than those reflected in market transactions might be wrong. If so, they might reduce rather than increase individual autonomy, as by preventing people from effectuating their shopping preferences through cookies. This suggests that government should move carefully in second-guessing market decisions. One way it could do so is by maximizing exit through an emphasis on state, rather than federal, regulation.

4. Externalities

Contracts may not lead to efficient results if they materially affect non-contracting parties. This is arguably the case, for example, with respect to restrictive software licenses that impede the flow of information and therefore inhibit productive efforts that would benefit society as a whole.[81] Some commentators claim that vendors' use of consumers' personal information involves social costs that the consumers themselves do not bear, as by restricting self-expression and thereby the choices made in a democratic society.[82] However, it is not clear why restricting self-

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[78] A recent anecdote tends to confirm this. Wired Magazine offered its readers a free device called :CueCat, a barcode reader for connecting subscribers with advertisers' websites. Wired's publisher wrote that "many [readers] aren't crazy about the idea." All three letters to the editor the magazine reprinted on the subject complained that advertisers could use the device to obtain information about readers. For example, one said: "Are we too dumb to notice that the point of the Cat is to track our shopping behavior? I'm not giving up that info for nothing." Wired, *Rants & Raves*, January, 2001 at 43. Wired readers, though more sophisticated than average, may be the marginal consumers for whom websites are designed.

[79] Because the website operator needs incentives to create additional value through the collection and aggregation of consumers' data, it would be inefficient to let the consumer extract all or most of this additional value. *See supra* text accompanying note 44.

[80] *See* Cohen, *supra* note 13; Reidenberg, *supra* note 9 at 1346.

[81] *See supra* text accompanying notes 18-19.

[82] *See* Reidenberg, *supra* note 9 at 1346-47. More generally, it is claimed that this information may construct a particular type of social truth that excludes other perspectives. *See* Cohen, *supra* note

expression by Internet tracking also would affect non-tracked decisions like those people make in voting booths. Moreover, as discussed above,[83] it is just as plausible that restricting consumer marketing information will impede individuals' expression of preferences.

A particular externality that may affect regulation of electronic commerce involves network effects. Network externalities are discussed in more detail below.[84] For present purposes it is enough to summarize the phenomenon as involving failure by new adopters of a standard or service to consider the benefits that adoption might confer on other users. The result is that people may not buy a new product or adopt a new standard even if it is better than the old one apart from network benefits, and a new product or standard might not emerge even if it might have given rise to a superior network but for externalities. Thus, information "norms" may be unfavorable to consumers,[85] or technical standards may not efficiently reflect consumer preferences. For example, the privacy standard P3P has been criticized in part on the ground that "[i]f not enough sites support the standard, consumers are not likely to deal with the daunting configuration, yet if not enough consumers demand it, marketers are unlikely to bother implementing it," thereby relegating consumers who prefer privacy to a "data ghetto."[86] This is essentially a claim that P3P will be unable to create a new "network" in which users efficiently can connect with websites. But this ignores the fact that, if a new standard such as P3P is efficient, vendors as well as users will gain, and therefore will have incentives to invest in marketing the standard. Conversely, the market's failure to adopt a new standard may be due to its inherent inferiority rather than to network externalities.[87] Thus, if P3P fails despite all of the attention it has been given and its high-profile backers that may be because few consumers want the privacy it enables.[88] If so, mandating the device through government regulation obviously will entrench inefficiency rather than curing a market failure.

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[83] *See supra* §I(B)(2).

[84] *See infra* §IV(C)(2).

[85] *See* Schwartz, *supra* note 13.

[86] *See* R.E. Bruner, *P3P: Programming Privacy, Executive Summary*, Vol. 1, No. 7 (June 30, 1998), available at http://www.exec-summary.com/trends/980630.phtml. P3P is discussed *infra* at note 101.

[87] This is analogous to the ambiguity regarding the failure of the Dvorak keyboard. *See infra* note 313.

[88] This problem would seem to be exacerbated by proposals to increase the level of P3P protection by enabling functions preferred only by the most privacy-sensitive users, such as the ability to ask detailed questions of the website operator. *See* Hunter, *supra* note 13 (noting critique of P3P by privacy advocates that users cannot ask questions about such matters as the type of business, where it is incorporated, whether it is a subsidiary of another company, and contact persons).

A final kind of externality concerns wealth distribution. It has been argued that permitting consumers to sell marketing information lets rich consumers reap merchant discounts while the poor get higher prices because merchants do not value their information.[89] But it is not clear that the advantage the rich get in this context can be distinguished from other problems associated with the allocation of wealth in a capitalist economy. The rich get better schools, housing, health care, information, and so forth, all of which enables them to get richer still. Perhaps this is social injustice that government should address, but it is not clear why government should start with electronic commerce.

Thus, arguments for government regulation of Internet contracting rest on questionable assumptions concerning consumers' ability to protect themselves and the existence of externalities. All of this is not to say that markets will operate perfectly. For example, even if most firms have market incentives to respect consumer privacy, a failing firm with no further reputation to protect may make an unauthorized one-shot sale of consumer data before going out of business. But it is unlikely any regulation could solve problems like this. More importantly for present purposes, even if some regulation is appropriate, it should not necessarily be the sort of all-out regulation that is imposed by federal law. As discussed below, state regulation and enforcement of contractual choice facilitates diversity, experimentation and competition among regulatory approaches.

D. ALTERNATIVE FORMS OF REGULATION

Even if some form of regulation is appropriate, it may not be clear what form the regulation should take. The following discussion compares some possible requirements concerning consumer marketing information. Many of these requirements have been proposed in state bills regulating consumer marketing information, as reflected in Table 1. This variety of approaches reflects the extent of experimentation that is possible under a state regulatory approach, and that would be precluded by full or even partial federal regulation of this area.[90]

1. Disclosure mechanisms

Regulation may require, or subject contract enforcement to the condition, that vendors disclose certain information to consumers. With respect to any disclosure requirement, the question for regulators is how the disclosure must be made. For example, vendors may be required to disclose via an information screen flashed to the individual user on logging on, a statement that the information is available at a specified web address or place on the website the consumer is already surfing, or by request by email, telephone or letter. The appropriate approach obviously depends on balancing the costs both to the vendor and the consumer of more affirmative disclosure methods, including forcing web surfers to click through

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[89] *See* Cohen, *supra* note 13.

[90] The possible effects of federal regulation are discussed below in Subpart V.

disclosure screens, against the benefits of reducing consumers' search costs.[91] The appropriate approach also may depend over time and across fact situations on rapidly developing technologies. For example, a form of privacy notice that is appropriate for a 19-inch monitor may not be appropriate for a PDA,[92] or its appropriateness for screens may depend on developments regarding screen resolution. Thus, prescribing a particular standard may stunt or inefficiently direct the development of technology.

2. Opting in vs. opting out

Regulators might provide for certain types of protection but allow contrary agreements. The main question in this situation is whether the consumer must opt into the protection or opt out of it. For example, a website operator might be prohibited from collecting any information *unless* it obtains the consumer's affirmative consent to the particular use, or *if* the consumer opts out of the practice the operator proposes, in either case after disclosure to the consumer. Or software might be sold with certain types of warranties *unless* consumers waive the protection. Consumer consent in either case might be as simple as clicking on an "I accept" box or even just deciding to use the website that gathers the information. On the other hand, the law might require an actual written, or at least electronic, signature. Where use of the product precedes precise disclosure, consent may or may not be predicated on the consumer's general knowledge of the information-gathering activity. An opt-in procedure draws the consumer's attention to her right to refuse to consent. By contrast, an opportunity to opt out of a web operator's or seller's practice, such as use of consumer marketing information, would give legal significance to consumer inaction, and therefore reduce the directness with which the consumer is presented by an explicit choice.

As with disclosure, the appropriate policy depends on balancing the costs to website operators and consumers of offering and making choices against the benefits to consumers of making the choices more obvious.[93] Aggressively presenting choices to consumers might give them more leverage over merchants. On the other hand, affirmative disclosures slow down consumers' web surfing, increase transaction times and tie up servers. While these costs increase directly with the number of disclosures, repetitively reminding consumers of privacy choices may have diminishing benefits.

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[91] Even for simple disclosure, the costs may not be trivial, and the benefits may be low. *See* Cate, *supra* note 6 at 33-4 (discussing notice requirements contained in HIPPA and Gramm-Leach-Bliley) and 52-5 (discussing compliance costs of these regulations). Cate notes that recently enacted Federal laws require notice in cases where the collection of information is obvious and no other use of the information is intended. *See also* Hahn, *supra* note 7.

[92] *See* Rubin, *supra* note 24.

[93] *See* ProCD v. Zeidenberg 86 F.3d 1447, 1451 (7th Cir. 1996); J. Howard Beals, III, *Economic Analysis and the Regulation of Pharmaceutical Advertising*, 24 SETON HALL L. REV. 1370, 1381 (1994); J. Howard Beals, III et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. 491 (1981).

3. Minimum requirements

The above discussion makes the amount of regulation turn on consumer choice. An alternative would be requiring websites to offer certain minimal protections, such as warranty or restrictions on use of marketing information, to all consumers. This approach could be combined with one of the others by requiring disclosure of additional protections, perhaps coupled with opt-in or opt-out rules. This alternative is generally identified with government regulation, and is discussed as such below. But a minimum standards approach also might be applied by private regulatory groups, or incorporated into consumer self-help if consumers configure their computers to accept only certain vendor policies. In the latter situation, the standard applies to all websites but varies from one consumer to the other.[94]

Again, policymakers must balance costs and benefits. Offering choices may

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[94] One set of minimum standards is embodied in so-called "Fair Information Practices." *See, e.g.*, Schwartz, *supra* note 13. An emerging standard of such practices is the 1980 Organization for Economic Cooperation and Development (OECD) *Guidelines on the Protection of Privacy and Transborder Flows of Personal Data*:

1. Collection Limitation Principle: There should be limits on the collection of personal data, and such data should be gathered legally, and with the knowledge or consent of the data subjects.

2. Data Quality Principle: Personal data should be relevant to the purposes for which they are to be used, and, to the extent necessary for those purposes, should be accurate, complete and kept up-to-date.

3. Purpose Specification Principle: The purposes for which personal data are collected should be specified not later than at the time of data collection, and all subsequent uses should be limited to those purposes.

4. Use Limitation Principle: Personal data should not be disclosed, made available or otherwise used for alternative purposes without consent from the data subject or by the authority of law.

5. Security Safeguards Principle: Personal data should be protected from unauthorized access, destruction, use, modification, or disclosure.

6. Openness Principle: There should be a general policy of openness about developments in data collection and use. Means should be readily available to ascertain the existence and nature of personal data, the main purpose of their use, and the identity and location of the data controller.

7. Individual Participation Principle: An individual should be able to contact a data controller about what information the controller has about that person, and be able to correct inaccurate records. If an access request is denied, a reason must be given, and the individual must be able to challenge the denial.

8. Accountability Principle: A data controller should be accountable for complying with the measures which give effect to the principles stated above.

consume valuable resources of both consumers and web operators. On the other hand, adopting minimum standards precludes some choices that might better balance costs and benefits. The efficiency of this approach depends on, among other things, consumers' ability to obtain and process information relevant to bargaining, regulators' ability to anticipate vendor and consumer preferences in particular situations, and the degree of variation among transactions. Thus, the efficiency of minimum standards may depend on who imposes the constraints. It might make sense for individual consumers or industries, but not for across-the-board federal regulation.

E. PUBLIC VS. PRIVATE REGULATORS

Rather than government's supplying default rules or enforcement mechanisms, firms could post their own rules or subscribe to organizations that supply the rules and police violations through fines or expulsion.[95] Johnson and Post discuss the potential for private regulatory structures on the Internet, possibly including consumer protection doctrines,[96] analogizing these organizations to the private regulatory structures that have developed in other areas, including securities exchanges[97] and the law merchant.[98] Third-party control and monitoring is currently provided by organizations such as TRUSTe.[99] Commercial entities might select private providers of legal rules whose judgments are enforced as final in the state court.[100] Another example is the "P3P" protocol, which would permit a kind of automated contracting whereby consumers' computers can block access by firms whose privacy policies do not meet user-configured standards.[101] This would permit

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[95] These organizations may not accurately be characterized as "self-regulatory," but rather as providing "regulation" based on contract or, like private ordering generally, as operating in the shadow of the law. *See* Lemley, *supra* note 33 at 1554 (describing self-regulation as "illusory").

[96] *See* David R. Johnson and David Post, *Law And Borders--The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367, 1380, 1383, 1390-91 (1996).

[97] *Id.* at 1392.

[98] *Id.* at 1389-90.

[99] *See* www.truste.org. TRUSTe licensees must abide by TRUSTe's policies concerning collection and use of consumer information, subject to TRUSTe's monitoring and auditing of licensees and resolution, reporting and possible referral to the FTC of consumer complaints. Other private organizations sponsoring consumer privacy efforts include those established by the Better Business Bureau (bbbonline) and the American Institute of Certified Public Accountants.

[100] *See* Gillian K. Hadfield, *Privatizing Commercial Law: Lessons From the Middle and the Digital Ages*, Stanford Law School, John M. Olin Program in Law and Economics Working Paper No. 195 (March, 2000), available at http://papers.ssrn.com/paper.taf?abstract_id=220252.

[101] *See* Lawrence Lessig, CODE AND OTHER LAWS OF CYBERSPACE, 160 (1999) (endorsing P3P as giving individuals a kind of automated property right in their information).

individuals, at low cost, to contract for precisely the level of privacy protection they prefer.[102]

The problem with these private solutions is that whether they are allowed to work depends ultimately on the level of government regulation. Thus, *permitting* private regulation should be viewed as a regulatory option. Regulators might choose to impose liability on web vendors for violation of rules of self-regulatory organizations, leave these violations to private procedures, or impose wholly separate regulations or remedies. For example, a firm may be liable if it changed its privacy policy after obtaining information without getting customer consent, could not adequately document how they used consumer information, or slipped in giving consumers access to their information. Although the firm could try to contract with the consumer to make private remedies exclusive, that contract might be rendered unenforceable by a judicial rule or regulation because of its "adhesive" nature.[103] This, in turn, would deter firms from relying on such private solutions. Johnson & Post assert that territorial governments will have incentives to grant "comity" to, and not interfere with, these regimes,[104] but these incentives are not self-evident.

F. SUMMARY

This Part has indicated the many policy issues and regulatory options relating to electronic commerce. These options are summarized in Table 2. This discussion is intended to emphasize the difficulty faced by a single set of federal regulators in formulating a regulatory policy in this area. This suggests the appropriateness of offering a multiplicity of approaches through 51 state legislators. The next Part discusses these and other advantages of state regulation.

II. ADVANTAGES OF A STATE LAW APPROACH

This Part discusses three important advantages of resolving the above issues through a multiplicity of state regulators. First, as discussed in subpart A, market participants' ability to exit states limits the extent to which powerful interest groups can control the regulation and secure inefficient rules that transfer wealth from weaker interest groups. Second, as discussed in subpart B, states can offer a variety of laws that suit different sets of preferences. Third, subpart C discusses how, even in the absence of active competition, a variety of state law facilitates experimentation with different alternatives and an evolutionary process as individuals and firms choose the laws that they prefer.

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[102] *See* Note, *Internet Regulation Through Architectural Modification: The Property Rule Structure of Code Solutions*, 112 HARV. L. REV. 1634 (1999).

[103] *See supra* §I(C)(2).

[104] *See* Johnson & Post, *supra* note 96 at 1391-4.

A. EXIT AND POLITICAL DISCIPLINE

Legislation may favor the interest groups that can organize most cheaply and effectively to raise and spend money, or to mobilize votes and other political resources.[105] Since a successful interest group's gains reflect its organization costs, these gains may not outweigh losses to the rest of society. Interest group dynamics at the federal level may lead to stringent regulation of consumer marketing information. Larger and more established website operators may favor disclosure and monitoring burdens that would restrict entry into the industry. This meshes with the interests of consumer advocates and trial lawyers who gain from increased remedies. Also, privacy advocates would favor legislation that heightens public awareness of the privacy issue and thereby increases the demand for these groups' lobbying activities. Large, established firms such as AOL may want federal regulatory standards suitable to a closed architecture or at least prefer federal preemption of burdensome state regulation to an open Internet.[106] Mostly lost in this mix are those who would tend to oppose strict regulation, including low-margin operators and potential new entrants who are hurt most by regulatory burdens, and consumers who prefer convenience to disclosure screens and "I accept" boxes.

Although interest groups operate at the state level as well, here the social costs of legislation are constrained by individuals' opportunities to exit undesirable regimes.[107] Charles Tiebout recognized that people decide on their preferred levels of taxes and expenditures by voting with their feet.[108] Any interest group compromise at the state level faces competition with the laws of fifty other jurisdictions operating on the level playing field set by the Constitution, including the dormant Commerce Clause.[109] By contrast, competition between U.S. federal law and that of other countries is constrained by the costs of dealing with different legal systems, languages and infrastructures and has no constitutional protection. The significant potential for exit in the U.S. federal system means that over-regulating state

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[105] *See generally* Mancur Olson, THE LOGIC OF COLLECTIVE ACTION (1971); Robert E. McCormick & Robert D. Tollison, POLITICIANS, LEGISLATION AND THE ECONOMY (1981); Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 361-62 (1988).

[106] Large global companies also might seek federal regulation to establish a level playing field with non-global companies that do not have to comply with more stringent non-U.S. regulation. *See infra* Part V.

[107] *See* Richard A. Epstein, *Exit Rights under Federalism*, L. & CONTEMP. PROBS., Winter 1992, at 147.

[108] Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956). *See also* Bruno S. Frey & Reiner Eichenberger, *Competition among Jurisdictions: The Idea of FOCJ*, *in* COMPETITION AMONG INSTITUTIONS, 209 (L. Gerken, ed.) (1995); Luder Gerken, *Institutional Competition: An Orientative Framework*, *in* Gerken, *supra*, at 1; Wolfgang Kerber & Viktor Vanberg, *Competition among Institutions: Evolution within Constraints*, *in* Gerken, *supra* at 33.

[109] *See infra* text accompanying notes 131-135.

lawmakers may lose clientele. Exit is a potentially more effective disciplinary mechanism than the political process because it operates through individual choice rather than the need to coordinate through interest groups. As exit costs fall, as by letting people contract for the applicable law rather than having to physically move from one jurisdiction to another, so does the effect of inefficient laws. For example, because firms easily can choose their states of incorporation, state corporation law has been described as "trivial."[110]

The above discussion shows that parties' ability to exit inefficient laws reduces the effect of these laws and therefore potentially increases efficiency. This is a relatively weak form of the state competition argument because it does not depend on exit's having any effect on the substance of the laws themselves, but rather only on the laws' effect on regulated parties. A stronger form of the argument is that exit, particularly given parties' ability to contract for the applicable law, disciplines state lawmakers to compete to enact efficient laws. This argument is discussed below.[111]

B. VARIATION AND INDIVIDUAL PREFERENCES

Legal rules are most likely to vary either when different rules are likely to have similar effects, so that the choice of a particular rule does not much matter, or when there is substantial disagreement or uncertainty over the effects or wisdom of alternative legal rules.[112] As discussed above, regulation of electronic commerce may be a prime example of the latter situation given not only the uncertainty concerning the effects and efficiency of various legal rules, but also varying effects in different situations.

Given these varying effects, state regulation may result in an equilibrium in which different laws appeal to different types of vendors rather than the emergence of a single dominant law. For example, some firms might seek the flexibility and lower transaction costs offered by a more permissive regime, while others would not take this option because its customers would be wary of such a choice. Firms would seek to cater to these different preferences just as they do regarding preferences along other dimensions.[113]

To the extent that a variety of regulatory approaches is desirable, relying on state law may provide significant advantages over a federal regime that broadly preempts state law. Under such circumstances, while state law would enable different

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[110] *See* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990).

[111] *See* Subpart IV(D)(1).

[112] *See* Saul Levmore, *Variety and Uniformity in the Treatment of the Good-Faith Purchaser*, 21 J. LEG. STUD. 43 (1987).

[113] Thus, merchants rather than customers "shop" for the applicable law, but do so with their customers' demands in view. *See infra* subpart IV(C).

regulatory approaches, federal and other centralized approaches would perversely attempt to achieve a uniform approach.[114] Thus, whether or not state competition effectively disciplines interest groups, relying on state law is more likely to allow firms and individuals to select from among different types of regulatory approaches, and to produce efficient variation.[115]

C. EXPERIMENTATION AND EVOLUTION

Even if a single law ultimately proves to be desirable, that law should not be imposed at the federal level until state experimentation identifies the best approach.[116] Once federal law is imposed, it is difficult for opponent interest groups to mobilize to change the law. Moreover, Web architecture and industry practices necessarily would follow the law, thereby making change costly.[117] On the other hand, a variety of state laws enables efficient alternatives to emerge and attract adherents even if state legislators are not knowingly competing or attempting to supply efficient laws.[118] This process operates in conjunction with the effects of exit discussed above in subpart A: Assuming only that market actors have incentives to minimize their transaction and information costs and an ability to choose legal regimes that accomplish this goal, efficient regimes will end up governing more transactions and inefficient regimes fewer transactions.[119]

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[114] For a discussion of this issue, see Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 134 (1996). See also Cate, *supra* note 6 at 53-4 (discussing overbroad application of recent federal approaches to privacy). Although it is theoretically possible for a federal or other centralized body to produce laws tailored towards specific industries and particular types of data, the centralized lawmaker is unlikely to have enough information to produce regulation appropriately tailored to specific contexts. *See infra* Part V.

[115] Indeed, web regulation is only one aspect of regulation of an industry, and this choice will reflect measuring the costs and benefits of one state's package of laws and regulations to that of another state.

[116] *See* Jack L. Goldsmith and Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 YALE L.J. 785, 821 (2001). (discussing benefits of state experimentation); Jack Knight, *A Pragmatist Approach to the Proper Scope of Government*, 157 J. INST. & THEORETICAL ECON. 28, 35 (2001) (noting the advantage of federalism in permitting experimentation with institutional forms); Martti Vihanto, *Competition between Local Governments as a Discovery Procedure*, 148 J. INST. & THEORETICAL. ECON. 411 (1992).

[117] This is an example of how the network externalities argument, even if it is valid, can work against as well as for regulation. *See infra* subpart IV(D)(2).

[118] *See* Armen Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950) (observing that a study of the "adaptive mechanism" of the market may be more fruitful than that of "individual motivation and foresight").

[119] There is also evidence of such evolution with respect to the demand for statutory forms. *See* Bruce H. Kobayashi & Larry E. Ribstein, *Evolution and Spontaneous Uniformity: Evidence from the*

III. THE TROUBLE WITH STATE LAW: OVER-REGULATION

This Part evaluates an important potential argument against relying on states to regulate electronic commerce: that this exposes sellers to regulation in every state in which their websites appear. Although complying with multiple rules may be costly for any business, it is arguably particularly so for a web vendor that presents buyers with a single interface on their web pages. Thus, Johnson and Post claim that territorial-based restrictions will lead to each jurisdiction's attempting to regulate the entire web, so that cyberspace itself should be considered a distinct regulatory jurisdiction.[120]

The real problem with state regulation of the Internet, however, is not that multiple states might regulate a given transaction, but rather how the regulating state is selected. As long as state regulation does not require inconsistent acts – as where some states prohibit disclosures that other states require – vendors can protect themselves by complying with the most rigorous state law that a court or regulator might apply. The problem is that, under open-ended default conflict-of-law and jurisdiction rules, the courts decide which state's law applies *ex post*, after a dispute arises, rather than *ex ante*, at the time of entering into the transaction.[121] This negates state law's advantage of offering a variety of regulatory alternatives by impeding parties' ability to choose the law that is most efficient or that best fits their situation.

This Part discusses the choice-of-law and jurisdiction rules that create this problem. This discussion shows that the over-regulation problem with state regulation of the web is not as serious as might first appear. As discussed below, under U.S. jurisdiction rules a state cannot regulate web transactions based solely on the local accessibility of the website. Also, in determining the applicable state law, a court needs to sort through only a limited number of options, and must evaluate only the sufficiency of the local basis for regulating rather than the claims of all states that can exercise jurisdiction.[122] Moreover, as discussed below in Part IV, state law becomes an even more viable approach to regulating the web when the potential for enforcement of contractual choice of law and forum is taken into account.

Evolution of the Limited Liability Company, 34 ECON. INQ. 464 (1996).

[120] *See* Johnson & Post, *supra* note 96 at 1379. This problem attained a global dimension with a French court's recent order that U.S.-based Yahoo must install a system blocking French users from accessing Nazi memorabilia on Yahoo or face stiff daily fines. *See* Mylene Mangalindan and Kevin Delaney, *Yahoo! Ordered To Bar the French From Nazi Items*, WALL ST. J., November 21, 2000, at B1, 2000 WL-WSJ 26617563. A U.S. federal court has decided to consider blocking the French order. *See Judge Agrees to Weigh Letting Foreign Courts Govern Yahoo! Auctions*, WALL ST. J., June 11, 2001 at B6.

[121] For general discussions, *see* Committee on Cyberspace Law, *Achieving Legal and Business Order in Cyberspace: A Report on Global Jurisdiction Issues Created by the Internet*, 55 BUS. LAW. 1801 (2000) ("*Order in Cyberspace*"); Jermyu Gilman, *Personal Jurisdiction and the Internet: Traditional Jurisprudence for a New Medium*, 56 BUS. LAW. 395 (2000).

[122] *See* Jack L. Goldsmith, *Against Cyberanarchy*, 65 U. CHI. L. REV. 1199, 1235, 1237 (1999).

A. CONFLICT-OF-LAWS

The Second Restatement of Conflicts applies an approach to determining the applicable law that depends on weighing a variety of facts in the particular case. If the transaction involves a breach of contract, as is likely the case for either software sales or use of consumer marketing information, the applicable law would depend on place of contracting, negotiation of the contract, performance, subject matter, and domicile, residence, nationality, place of incorporation and place of business of the parties,[123] weighed in light of such general considerations as the parties' expectations and the policies of the forum and other interested states.[124] Alternatively, under the Uniform Commercial Code (UCC), a court would apply its own law if the transaction bears "an appropriate relation to this state."[125]

If merchants' use of consumer marketing information is considered a tort invasion of privacy,[126] the applicable law may be that of the state where the defendant communicated the information and thereby appropriated the plaintiff's name or likeness, or the plaintiff's domicile if the invasion is deemed to occur in multiple states.[127]

These rules obviously could support application of the buyer's local law in many electronic commerce cases.[128] For example, if the case involves a software sale, or if the court deems the vendor's use of cookies to be a breach of its contract with the buyer, it might reason that the consumer's purchase, or the vendor's placing a cookie on a consumer's computer, locates the performance, subject matter, one of the parties, and perhaps contracting and negotiation in the consumer's state. If sale of a consumer marketing information database is considered a tort breach of privacy, the applicable law may be that of the plaintiff's domicile, the purchaser's location, or some other place.

The Constitution only loosely checks state courts' selection of the applicable law. *Allstate Insurance Co v. Hague* held as a matter of Due Process and Full Faith and Credit that Minnesota, where the decedent worked, widow resided and insurer did

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[123] RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188(2) (1971).

[124] *Id.* §6.

[125] UCC §1-105.

[126] *See supra* note 37 and accompanying text.

[127] *See id.* §152 and comment c (stating that law of place of invasion applies unless some other state has more significant relationship under §6); §145(f), 153 (noting importance of plaintiff's domicile in multistate cases).

[128] For an argument that default choice-of-law rules should call for application of buyer's state because sellers would be in the best position to contract around this default *see* O'Hara & Ribstein, *supra* note 151 at 1201.

business, could apply its rule "stacking" uninsured motorist coverage on the insureds' vehicles rather than the different Wisconsin rule where the policy was issued and the insured resided, reasoning that Allstate would not be unfairly surprised by the application of Minnesota law.[129] An expectations-based test provides little predictability as long as the parties' expectations can be shaped by the choice-of-law rules the courts happen to apply.[130]

The dormant Commerce Clause might play some role in choice of law.[131] The Supreme Court arguably has endorsed an interpretation of the Commerce Clause that invalidates state regulation that involves significant "spillovers" -- that is, its costs fall mostly on interest groups outside the state while its benefits accrue to those within it.[132] This theory could be applied to regulation of the Internet. Indeed, courts have invalidated on Commerce Clause grounds state statutes regulating Internet conduct based on minimal jurisdictional contacts that significantly burdened multi-state Internet operations.[133]

However, state regulation should not be deemed to violate the dormant commerce clause merely because it might have out-of-state effects. Rather, courts should, and in effect do, balance any costs imposed on out-of-state parties against the local harms the statute is intended to redress.[134] Courts must analyze costs and benefits

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[129] 449 U.S. 302. 318, n. 24 (1981). Justice Stevens, concurring, said that the parties' expectations are significant under the Full Faith and Credit Clause, *id* at 324 n.11, and suggested that the Due Process Clause would raise fairness concerns if the parties had made their expectations explicit by providing for application of a particular law, *id.* at 328-29.

[130] For analysis and criticism of one author's argument against the constitutionality of enforcing choice-of-law clauses under the Full Faith and Credit clause, *see infra* text accompanying note 204.

[131] *See* Larry E. Ribstein, *Choosing Law By Contract*, 18 J. CORP. L. 245, 287-94 (1993).

[132] *See* Richard A Posner *Economic Analysis of Law*, 699-700 (5th edition 1998); Daniel R. Fishel, *From MITE to CTS: State Anti-Takeover Statutes, the Williams Act, the Commerce Clause, and Insider Trading*, 1987 SUP. CT REV. 47; Saul Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VAND. L. REV. 568 (1983). *Cf.* Hatch v. Superior Ct., 79 Cal.App.4th 663, 94 Cal.Rptr.2d 453 (2000), discussed in *infra* note 133 (California statute did not violate Commerce Clause because statute did not punish conduct outside of California).

[133] For cases invalidating statutes prohibiting distribution of obscene material to minors on the Internet, *see* ACLU v. Johnson, 194 F.3d 1149 (10th Cir. 1999); American Ass'n v. Pataki, 969 F. Supp. 160, 169 (S.D.N.Y. 1997) (reasoning that the Internet "must be marked off as a national preserve to protect users from inconsistent legislation that, taken to its most extreme, could paralyze development of the Internet altogether"). *But see* Hatch v. Superior Ct., 79 Cal.App.4th 663, 94 Cal.Rptr.2d 453 (2000) (holding that California statute did not violate Commerce Clause because statute did not punish conduct outside of California).

[134] *See* Goldsmith & Sykes, *supra* note 116.

of state regulation of electronic commerce in light of the available and potential technology, including website operators' ability to block access to their website by users in particular states, and users' ability to configure their browsers to avoid intrusive websites.[135] Thus, the application of the Commerce Clause to electronic commerce may depend on how easily website operators can restrict access to their sites or avoid sales in states where their websites are illegal, whether application of the law takes such efforts into account, and on whether customers can cheaply avoid dealing with companies whose sales or privacy policies they do not like. In other words, Constitutional constraints may not be justified under a balancing test for the same reasons that state law is ultimately likely to produce efficient results, as discussed below in this Part.

B. JURISDICTION

The applicable state law is determined not only by conflict-of-laws rules but also by where the plaintiff can obtain personal jurisdiction over the defendant. The Due Process clause permits the state to assert jurisdiction over only those parties who have had minimum contacts with the state.[136] The most likely rule to be applied is that the jurisdiction must be based on an action directed toward the forum rather than merely on defendant's awareness that action might result there.[137] Once a state with jurisdiction enters judgment, the judgment may be enforced in any state where the defendant has assets.[138]

Internet jurisdiction has gone through three phases. A few courts initially held that a state could exercise jurisdiction merely on the basis that a website was

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[135] This technology is discussed *infra* note 208 and accompanying text.

[136] *See generally* World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980); International Shoe Co. v. Washington, 326 U.S. 310 (1945).

[137] *See* Asahi Metal Industry Co v Superior Court, 480 US 102 (1987). Although five justices refused to endorse the standard summarized in the text, only one (Stevens) remains on the Court, while three of the four justices who supported the more restrictive standard cited in the text remain on the Court. Note that a court may assert general jurisdiction over a defendant that has extensive local contacts such as maintaining a principal place of business even if the contacts did not arise out of or relate to the particular transaction at issue. See Helicopteros Nacionales De Columbia, S.A. V. Hall, 466 US 408 (1984). Merely selling through a website into a forum is clearly insufficient for this purpose. *See* DEC v. Altavista Technology, Inc., 960 F. Supp. 456 (D. Mass. 1997). *See also* Coastal Video Communications, Corp. v. Staywell Corp., 59 F. Supp. 2d 562 (E.D. Va. 1999) (holding no specific jurisdiction in Virginia for declaratory judgment action by out of state plaintiff based on accessibility of defendant's interactive website in Virginia, although general jurisdiction might be supported by proof the website was accessed by many residents in the forum, indicating continuous and systematic contacts).

[138] *See* Full Faith and Credit clause, US Const, Art IV, § 1. For recognition of this principle *see* Shaffer v. Heitner, 433 U.S. 186, 210, n. 36 (1977).

broadcast into the state.[139] However, courts now generally deny personal jurisdiction based merely on a receiver's downloading.[140] In the second phase of Internet jurisdiction cases, the courts focused on the degree of interactivity of the website in the relevant jurisdiction.[141] Several cases have based jurisdiction primarily or exclusively on the maintenance of an interactive website that can take orders.[142]

In the third phase, a defendant may be able to escape jurisdiction in a state if it has not "targeted" that jurisdiction or has targeted its conduct elsewhere. The leading case suggesting this approach, *GTE New Media Services, Inc. v. Bellsouth Corp.*, reasoned that due process requires predictability, analogizing web access to an out-of-state telephone call which had been held not to trigger long-arm jurisdiction, and distinguishing cases involving activities directed toward the forum that had held in favor of minimum contacts.[143] In one of these cases, *CompuServe, Inc. v. Patterson,*[144] the defendant had contracted with a locally-based computer network to market his

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[139] *See* Inset Systems, Inc. v. Instruction Set, Inc., 937 F. Supp. 161 (D. Conn. 1996); Maritz, Inc. v. Cybergold, Inc., 947 F. Supp. 1328 (E.D. Mo. 1996) (basing jurisdiction on defendant's decision to transmit advertising information to all Internet users). The Virginia Internet Privacy Act pushes this approach to its outermost reach providing for jurisdiction in Virginia based merely on routing of email or other Internet transmissions through Virginia. *See* VA. CODE ANN. § 8.01-328.1. While this may be a boon for local Internet service providers, particularly including AOL, who want to sue remote users of their service, it is probably unconstitutional under the more restrictive approaches to jurisdiction discussed in the text below. ISP's probably are better off relying on contractual consent-to-jurisdiction clauses. *See infra* note 164 and accompanying text.

[140] *See* Bensusan Restaurant Corp. v. King 937 F. Supp. 295 (S.D.N.Y. 1996), aff'd 126 F.3d 25 (2d Cir. 1997) ("[t]he mere fact that a person can gain information on the allegedly infringing product is not the equivalent of a person advertising, promoting, selling or otherwise making an effort to target its product in New York."); Goldsmith, *supra* note 122 at 1216-21.

[141] *See* Cybersell, Inc. v. Cybersell, Inc 130 F 3d 414 (9th Cir. 1997) (holding that the court should look to the level of interactivity and analyze contacts in the jurisdiction; in the present case site invited visitors to submit name to get more info; passive web operation not enough); Zippo Manufacturing Co. v. Zippo Dot Com, Inc., 952 F. Supp. 1119 (W.D. Pa. 1997) (for interactive website, the court must determine the degree and nature of the information exchange through the site).

[142] *See* Park Inns Intern., Inc. v. Pacific Plaza Hotels, Inc., 5 F. Supp. 2d 762 (D. Ariz. 1998), (website could take hotel reservations); Stomp, Inc. v. NeatO, LLC, 61 F. Supp. 2d 1074 (C.D. Cal. 1999) (website permitted a small number of on-line sales); Online Partners.Com, Inc. v. Atlanticnet Media Corp., 2000 WL 101242 (N.D. Cal. 2000) (website permits online subscriptions); Citigroup Inc. v. City Holding Co., 97 F. Supp. 2d 549 (S.D.N.Y. 2000) (website permitted customers to apply for loans on-line, print out applications for fax submission, click on a "hyper link" to "chat" on-line with a representative of defendants and e-mail defendants with home loan questions with a quick response from an online representative).

[143] 199 F. 3d 1343, 1349-50 (D.C. Cir. 2000).

[144] CompuServe, Inc. v. Patterson, 89 F.3d 1257 (6th Cir. 1996).

software, which he electronically sent to the state. In the other, *Panavision International, L.P. v. Toeppen*,[145] a "cybersquatter" who allegedly stole defendant's trademarks engaged in conduct that had effects in the relevant state, California, which was the trademark owner's principal place of business and the heart of the motion picture and television industry. It has been said that *GTE* endorses a "strict purposeful availment standard," and that "[b]ecause defendants can control whether they engage in activities targeted toward a specific forum, it is easier for them to predict whether a court will find that they have done so than to predict whether a court will label their websites as sufficiently interactive to warrant jurisdiction."[146] Some other cases also hint at a targeting standard.[147]

The ABA Committee on Cyberspace Law has recommended a targeting limitation based on devices sponsors use to purposefully avail themselves of states' commercial benefits, or that they use to avoid jurisdictions, such as blocking and screening, disclaimers, identification of their home state, listing targeted or non-targeted destinations and, more generally, controlling how goods are advertised, sold, and shipped.[148] Restrictions on jurisdiction also may take into account the availability of bots, or intelligent agents, that consumers can program to prevent access to particular sites, aided by sellers' electronic agents and global protocol standards.[149]

In general, although the law is still developing, the trend in jurisdiction law is toward viable limits on state law's reach. Technology and flow-control will determine the meaning of minimum contacts in cyberspace, and ultimately may erect electronic borders that make personal jurisdiction in cyberspace comparable to that in

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[145] 141 F.3d 1316 (9th Cir.1998).

[146] See Note, *Civil Procedure--D.C. Circuit Rejects Sliding Scale Approach To Finding Personal Jurisdiction Based on Internet Contacts*, 113 HARV. L. REV. 2128, 2133 (2000).

[147] *See* Roche v. Worldwide Media, Inc., 90 F. Supp. 2d 714 (E.D. Va. 2000) (though website solicited customer e-mail addresses and credit card numbers, no evidence that products were sold in Virginia or that any advertising or other promotional activity was directed specifically to Virginia); Rannoch, Inc. v. Rannoch Corp., 52 F. Supp. 2d 681 (E.D. Va. 1999) (denying jurisdiction in infringement case, where website included section for ads that could be placed on line, though no sales on line, stating that "[t]here was no evidence that the defendant had any dealings with any Virginia resident, placed any classified ads on its Website for products or persons in Virginia, did any business in Virginia, or conducted any advertising or other promotional activity specifically directed to Virginia."). *Cf.* Uncle Sam's Safari Outfitters, Inc. v. Uncle Sam's Army Navy Outfitters-Manhattan, Inc., 96 F. Supp. 2d 919 (E.D. Mo. 2000) (holding that disclaimer re sale of merchandise in Missouri is unavailing because it was posted after the commencement of the suit).

[148] *See Order in Cyberspace*, *supra* note 121 at 1821, 1881. For example, a website might announce exclusion operator might post a notice excluding residents of certain countries. *Id* at 1892.

[149] *Id.* at 1879, 1893-94. *See also* the discussion of P3P, *supra* text accompanying notes 101-102.

real-space.[150] Based solely on rules regarding choice of law and jurisdiction, it sometimes may be difficult for web vendors to predict precisely which state's law will be applied at the time of the transaction. However, as discussed in the next Part, *ex ante* predictability may be enhanced by contractual choice of law and forum, particularly when these are combined with the limitations on jurisdiction discussed above.

IV. A CONTRACTUAL SOLUTION

This Part discusses an important way of enhancing the viability of state regulation of the Internet – through enforcement of contractual choice of law and forum. Subpart A discusses the law on enforcement of these contracts. Subpart B discusses how firms can induce increased enforcement through their power to avoid non-enforcing jurisdictions. Subpart C responds to arguments that this might lead under-regulation of electronic commerce. Subpart D discusses the emergence of efficient state law from enforcement of contractual choice.

A. ENFORCING JURISDICTIONAL CHOICE

The above rules do not necessarily let merchants and consumers jointly determine the applicable rules at the time of their transaction, when the winners and losers from a particular rule have not yet been determined and when knowledge of the law could shape the parties' conduct. Rather, they let consumers choose the law unilaterally at the time of injury by picking a forum, which in turn has substantial latitude in picking local law. Under this approach, states have incentives to respond to consumers' or trial lawyers' interests rather than to maximize the contracting parties' joint wealth.[151]

Web vendors can, however, counteract this through their ability contractually to select the applicable forum, adjudicator and law. Enforcing these clauses maximizes the welfare of all affected parties rather than just of the one who happens to sue. Contractual jurisdictional choice addresses the most significant problems inherent in diverse state laws. These contracts are particularly useful in dealing with state regulations that, for example, impose onerous mandatory limitations on software licenses, restrict use of consumer information even with disclosure, require onerous disclosures or consent procedures, significantly impose costly consumer access requirements, or provide for draconian liability.

More specifically, under our proposal, merchants might condition use of their websites on the consumers' acceptance of the designated law and forum. Such a

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[150] *See* Goldsmith, *supra* note 122 at 1218-19, 1226-7.

[151] Thus, the problem is not simply that the rules are unclear. Rather, even clear rules that always apply the forum rule and that the consumer can obtain jurisdiction anywhere over the merchant would present the same problems. *See* Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151, 1187-90 (2000).

clause was enforced in the consumer marketing information context:

> This License Agreement shall be governed by the laws of the State of Washington, without regard to conflicts of law provisions, and you hereby consent to the exclusive jurisdiction of the state and federal courts sitting in the State of Washington. Any and all unresolved disputes arising under this License Agreement shall be submitted to arbitration in the State of Washington.[152]

The contract might be entered into by placing the clause in a general "terms of use" section of the website, or by making acceptance of the clause a condition of entering the website. Alternatively, states might offer firms the opportunity to select their laws through a procedure analogous to incorporation or formation of other types of business associations. For example, a Virginia bill proposed permitting firms to "domesticate" their websites in Virginia by making a local public filing, and thereby effectively to disclaim certain types of liabilities.[153]

The following subsections address various aspects of the enforcement of these clauses.

1. General rules on enforcing contractual choice of law and forum

Current law appears to give courts significant leeway not to enforce contractual choice of law. As summarized in *Restatement (Second) of Contracts,* §187(2), courts may refuse to enforce such clauses as to the validity of the contract where:

> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
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> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of §188, would be the state of the applicable law in the absence of an effective choice of law by the parties.[154]

The first exception may restrict shopping for the applicable law in some cases by requiring a connection with the chosen jurisdiction. The second limitation can operate to prevent evasion of state regulation.

Courts applying the *Restatement* rule have quite generally enforced contractual

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[152] *See* Lieschke v. RealNetworks, Inc., 2000 WL 198424 (Feb. 11, 2000, N.D.Ill.), additional opinion, 2000 WL 631341 (May 8, 2000, N.D.Ill.), discussed *infra* text accompanying note 184.

[153] *See* 2000 VA S. 767.

[154] *See* RESTATEMENT (SECOND) OF CONFLICTS, §187(2) (1971).

choice of law, at least in commercial contracts.[155] Several states, including California, Illinois, Delaware, New York and Texas, have promulgated statutes that, to varying degrees, clarify the enforcement of contractual choice-of-law clauses in large, commercial-type cases.[156] Also, the Uniform Commercial Code (UCC) provides that, "when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties."[157] Thus, the UCC does not currently include the Second Restatement "fundamental policy" exception.

The enforceability of contractual choice is most doubtful in consumer cases and in statutory provisions that apply to such cases. The court may refuse to enforce the contract because it may have doubts about consumers' ability to make an informed decision and to have a realistic choice concerning choice of law. The court may first determine that the contractually selected state's law is inapplicable under law concerning contract validity,[158] which may be determined by the Restatement test discussed immediately above, and then determine the applicable law under the open-ended default choice-of-law rules that applies in the absence of contract.[159]

Perhaps the most important limitation on contractual choice in consumer cases is forthcoming in the American Law Institute's revision of the Uniform Commercial Code.[160] The draft proposed for adoption would sharply distinguish consumer and non-consumer transactions. Although the proposed provision would enforce contractual choice in business-to-business transactions as long as it has a "reasonable relationship" to the transaction,[161] and is not contrary to a fundamental policy of the State or country whose law would govern in the absence of

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[155] *See* Ribstein, *supra* note 131; Symeon C. Symeonides, *Choice of Law in the American Courts in 1997*, 46 AM. J. COMP. L. 233, 273 (1998). Thus, the U.S. rule in this context resembles the apparently more liberal rule in the leading U.K. case of Vita Food Products Inc. v. Unus Shipping Co. 1939 A.C. 277(enforcing a provision applying English law to a transaction whose only connection with England was the choice-of-law clause). Cases involving the consumer context are noted in *infra* note 71 and accompanying text.

[156] Larry E. Ribstein, *Delaware, Lawyers and Choice of Law*, 19 DEL. J. CORP. L. 999, 1003-06 (1994).

[157] U.C.C. §1-105 (1).

[158] For an example of this decision-making process in an electronic commerce case, *see infra* note 197.

[159] *See supra* subpart III(A).

[160] Revision of Uniform Commercial Code, Draft for Approval, §1-301, available at http://www.law.upenn.edu/bll/ulc/ucc1/Ucc161401.htm.

[161] *See id.* §1-301(b)(1).

agreement."[162] For transactions in which one of the parties is a consumer, however, the revision would refuse to enforce the clause where the chosen law would "deprive the consumer of the protection of any rule of law, that both is protective of consumers and may not be varied by agreement, of the State or country: (A) in which the consumer habitually resides, unless subparagraph (B) applies; or (B) if the transaction is a sale of goods, in which the consumer makes the contract and takes delivery of those goods, if such State or country is not the State or country in which the consumer habitually resides."[163]

As noted above, courts have stronger incentives to enforce contractual choice of forum and adjudicator than to enforce contractual choice of law. This is confirmed by the case law. U.S. Supreme Court cases have recognized the enforceability of consent to jurisdiction,[164] and forum-selection[165] clauses even in "adhesion" contracts between merchants and consumers.[166] Although the Supreme Court was deciding constitutional issues or admiralty cases rather than applying state law, the cases are important general recognition of enforceability.

With respect to arbitration clauses, Section 2 of the U.S. Federal Arbitration Act[167] mandates enforcement of arbitration agreements involving transactions in interstate commerce. Consistent with its approach to choice of forum, the Supreme Court has been very receptive to enforcement of arbitration clauses even in cases involving important federal rights.[168]

2. The link between choices of law, forum and adjudicator

It is important to emphasize the importance of contracting not only for the applicable law, but also to require disputes to be tried in the state whose law is selected and that the parties consent to the jurisdiction of this court. Because the forum court ultimately decides which law to apply, the parties seeking the application

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[162] *Id.* §1-301(e).

[163] *Id.* §1-301(d).

[164] *See* National Equipment Rental, LTD. v. Szukhent, 375 U.S. 311 (1964); Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985).

[165] *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991); M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972).

[166] *See* Carnival Cruise Lines, *supra* note 165 (enforcing choice of forum clause on passenger ticket). The efficiency of "adhesion" contracts is discussed *supra* note 72 and accompanying text.

[167] 9 U.S.C. §2.

[168] *See, e.g.*, Gilmer v. Interstate/Johnson Lane Corp., 111 S.Ct. 1647 (1991) (employment discrimination); Rodriguez de Quijas v. Shearson/American Express Inc., 490 U.S. 477 (1989) (securities law claim).

of a particular state law likely will choose the forum that is most likely to apply that law, including a forum that is likely to enforce the parties' contractual choice. Also, because a court has a tendency to apply its own law, and a comparative advantage in applying this law, the contractual choice of law and forum likely will be the same.[169]

Although a court in which plaintiff sues theoretically can decide not to enforce a choice-of-forum clause, it may be willing to defer to the contractual selection of a different forum even if it would not be willing to apply another state's law.[170] While a judge may face difficulty without much reward from making new law when applying another state's law, enforcing a choice of forum clause lets a court both enforce the contract and avoid directly contravening legislative policy or establishing a potentially troublesome precedent on contractual choice of law. Thus, contractual choice of forum helps courts resolve conflicting incentives regarding enforcement of contractual choice of law.

The contract also might adopt a private regulatory regime or provide for arbitration.[171] Again, a court may be willing to permit arbitration even if it would not enforce contractual choice of law.[172] Although state judges have incentives to enforce local law because the local legislature controls their tenure, salary and perks,[173] arbitrators have less incentive to resist evasion of state regulation because they are paid by the parties rather than by the state. A recent paper confirms this observation by showing that franchisers tend to use arbitration clauses in their agreements when they also contract for the applicable law.[174]

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[169] *See* Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom,* in THE FALL AND RISE OF FREEDOM OF CONTRACT (F.H. Buckley, ed. Duke, 1999).

[170] Whether or not the parties have contractually selected the forum, courts have the alternative of dismissing on forum non conveniens grounds or, in federal court, transferring the case to the jurisdiction whose law is chosen. *See* Note, *Forum Non Conveniens as a Substitute for the Internal Affairs Rule,* 58 COLUM. L. REV. 234 (1958).

[171] *See* Goldsmith, *supra* note 122 at 1246-9 (arguing for solving many problems through international arbitration operating through contract, national arbitration law, international enforcement treaty).

[172] *See* Kobayashi & Ribstein, *supra* note 169.

[173] *See* Gary M. Anderson, et al. *On the Incentives of Judges to Enforce Legislative Wealth Transfers,* 32 J. L. & ECON. 215 (1989); W. Mark Crain & Robert D. Tollison, *Constitutional Change in an Interest Group Perspective*, 8 J. LEGAL STUD. 165 (1979) and *The Executive Branch in the Interest-Group Theory of Government,* 8 J. LEGAL STUD. 555 (1979); William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest Group Perspective*, 18 J. L. & ECON. 875 (1975).

[174] *See* Keith N. Hylton & Christopher R. Drahozal, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts,* at 25, B.U. School of Law, Law & Econ. W.P. 01-03, http://papers.ssrn.com/paper.taf? abstract_id=266545 (2001).

There is an important relationship between contracting over the forum and contracting for private remedies. States may regulate Internet transactions whether or not the parties want to deal with the problem only in cyberspace. A consumer or regulator therefore may circumvent attempted contractual privatization by suing in a state that is likely to apply its strong regulatory policy. Thus, firms effectively can contract for private rather than government rules and adjudication only by contractually designating a state forum that respects private remedies. Accordingly, our proposal for enforcing contractual choice of state law and forum does not mean that we prefer government to private ordering, but rather provides a way to make private remedies viable. We do not necessarily disagree with Johnson & Post's arguments for private regimes operating and competing in cyberspace.[175]

3. Enforcing the clauses in electronic commerce cases

This subsection considers enforcement of contractual choice of law, forum and adjudicator in the specific context of electronic commerce. Whether consumers' bargaining and information problems may lead to a "race-to-the-bottom" in electronic commerce law is discussed below.[176] For present purposes it is enough to note that, consistent with the above analysis of so-called "adhesion" contracts, merchants' designation of the applicable law without bargaining does not necessarily make the contract one-sided or unenforceable.[177] Consumers, in effect, vote with their mice for the applicable law and forum by contracting with the seller or website operator, perhaps using an automatic contracting mechanism such as P3P.[178] Moreover, consumers' lack of information concerning various legal systems is not as serious a problem as might first appear given various market devices and the availability of abundant information.

The law on enforcing contractual choice in electronic commerce cases reflects a division in the courts concerning the nature of the requisite consent in Internet contracting generally. Recent federal and state decisions have enforced arbitration provisions in Gateway's mail order and telephone computer sales without evidence of plaintiff's overt consent or actual awareness of the provision.[179] In a frequently cited case, *Hill v. Gateway 2000, Inc.*[180] Judge Frank Easterbrook held in favor of enforcement of the clause in a contract included with a Gateway computer

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[175] *See* Johnson & Post, *supra* note 96, at 1399, n. 102.

[176] *See infra* subpart IV(C).

[177] *See supra* note 72 and accompanying text.

[178] *See supra* text accompanying note 101.

[179] *But see* Klocek v. Gateway 2000, Inc., 104 F.Supp.2d 1332 (D. Kans. 2000) (holding against enforceability in this context because plaintiff did not accept the relevant terms).

[180] 105 F. 3d 1147 (7th Cir.), *cert. denied* 522 U.S. 808 (1997).

based on retention of the computer for the requisite period to indicate consent under the agreement even in the absence of explicit consent.[181] A later federal case, relying on *Hill,* held that the arbitration clause in the license accompanying the computer purchase was broad enough to cover related purchase of software services although there was no arbitration clause in the agreement specifically relating to those services.[182] In *Brower v. Gateway 2000, Inc.*,[183] a New York state court, also relying on *Hill,* held that the provision was not unenforceable as an unconscionable "adhesion" contract despite inequality of bargaining position between the seller and the consumer, the consumer's failure to read or understand the agreement, and the fact that the arbitration provision foreclosed a low-cost class action remedy. It was enough that the consumer had thirty days after receiving the computer and agreement to return it (although return would have entailed expense and inconvenience), and that the agreement was not unduly lengthy (three pages and 16 paragraphs, all in the same size print). The court did invalidate the agreement, but on the sole ground that it designated arbitration by the International Chamber of Commerce, an organization based in France and little known in the U.S.

Judicial recognition of jurisdictional choice has been extended to clickware Internet contracts. An important recent case involving consumer marketing information is *Lieschke v. RealNetworks, Inc.*,[184] in which the court enforced contractual arbitration in defendant's home state of customers' claims of trespass to property and privacy based on RealNetworks' use of its products to access users' electronic communications and stored information without their knowledge or consent. Before installing the software users were required to accept RealNetworks' license agreement quoted above,[185] which provided that Washington law governed and that users consented to exclusive jurisdiction and arbitration in state and federal courts in Washington. The court interpreted this as applying the law of the Seventh Circuit (the forum) as to arbitrability, which, as discussed immediately below, is notably favorable to enforcement of computer and software agreements,[186] rather than the less pro-enforcement law of the Ninth Circuit, where the contractually selected forum was located.[187] It also rejected an intervenor's unconscionability arguments

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[181] *See* Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir.), *cert. denied,* 522 U.S. 808 (1997).

[182] Westendorf v. Gateway 2000, Inc., 2000 WL 307369 (Del. Ch., March 16, 2000).

[183] 246 A.D.2d 246, 676 N.Y.S.2d 569 (1998).

[184] 2000 WL 198424 (Feb. 11, 2000, N.D.Ill.), additional opinion, 2000 WL 631341 (May 8, 2000, N.D.Ill.).

[185] *See supra* text accompanying note 152.

[186] *See supra* note 180.

[187] 2000 WL 631341 at 5 (May 8, 2000, N.D.Ill.). Citing the presumption of arbitrability under the Federal Arbitration Act, the court held that plaintiffs' non-contract arguments were those "arising under" the agreement pursuant to the arbitration clause, and rejected their arguments that

based on the location of the agreement, the size of the font, difficulty of use, distance of the designated forum from some users' homes, and the failure to provide for class-wide arbitration.[188]

Courts have enforced contractual choice of law and forum in other types of Internet transactions. New Jersey residents injured in defendant's Nevada hotel had to go to Nevada for trial under a clause entered into on defendant's website providing for trial in Nevada state and federal courts.[189] The forum selection clause helped justify holding against jurisdiction in New Jersey, the court reasoning in part that "[t]he forum selection clause in defendant's Website demonstrates that it could not reasonably anticipate being haled into court in New Jersey." Contractual choice of Ohio law was enforced in a declaratory judgment action on an Internet transaction based on repeated interactions between an Ohio computer network and a customer who agreed to market his product over defendant's system.[190]

The Uniform Computer Information Transactions Act (UCITA) also strongly supports contractual choice of law and forum in the context of computer information sales, and perhaps also in consumer marketing information transactions also under a trade secret licensing approach to those transactions.[191] UCITA would enforce a choice of law clause in electronic consumer sales unless it would vary a mandatory rule in the licensor's state.[192] UCITA drops the "reasonable relationship"

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they should not be required to arbitrate because of the high cost of arbitrating individual claims. 2000 WL 198424 (Feb. 11, 2000, N.D.Ill.).

[188] 2000 WL 631341 at 5-7.

[189] Decker v. Circus Circus Hotel, 49 F. Supp. 2d 743, 750 (D.N.J. 1999).

[190] CompuServe, Inc. v. Patterson, 89 F.3d 1257 (6th Cir. 1996). However, one court refused to enforce contractual choice of California law in a case involving a Texas plaintiff's participation in Internet computer games run by a defendant whose principal place of business and server were located in California. Thompson v. Handa-Lopez, Inc., 998 F. Supp. 738 (W.D. Tex. 1998). The court held that the choice of law clause was not a forum selection clause because, although the contract provided for final and binding arbitration in California, it did not require filing a suit in California. *Id.* at 745. The court added that Texas had a strong interest in protecting its citizens from breach of contract, fraud, and violations of the Texas Deceptive Trade Practices Act that outweighed the defendant's burden created of defending in Texas. *Id.*

[191] *See* Samuelson, *supra* note 13.

[192] UNIF. COMPUTER INFORMATION TRANSACTIONS ACT, §109(a) (Draft for Approval at NCCUSL Meeting, July 23-30, 1999), *available at* <http://www.2bguide.com/drafts.html>:

> The parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply under subsections (b) and (c) in the absence of the agreement.
>
> The default rule under §109(b) applies the law of the state in which the licensor is located in

requirement under the general Restatement rule for enforcing contractual choice of law.[193] The Reporter's Notes state that in a "global information economy, limitations of that type are inappropriate and arbitrary" and cite the costs of complying with the inconsistent laws of many jurisdictions as the reason for mandating application of the law of the licensor's state in electronic transactions.[194] Although the rule upholds mandatory rules in states where licensors are located, licensors they can escape application of stringent rules in states that adopt this UCITA provision by establishing the contacts that UCITA finds critical, including place of business and chief executive office,[195] in permissive states. The Reporter's Note to the Uniform Computer Information Transaction Act also adopts a permissive approach to enforcing choice of forum clauses, noting that the choice "is not invalid simply because it has an adverse effect on a party, even if bargaining power is unequal" and that "[i]n an Internet transaction, choice of forum will often be justified on the basis of the international risk that would otherwise exist. Choice of a forum at a party's location is reasonable."[196]

There is, however, authority against enforcing contractual arbitration in an Internet transaction that did not, as in *Lieschke*, require the consumer to asset before downloading the product. In *Specht v. Netscape Communications Corp*,[197] the court refused to enforce an provision for binding arbitration in California in what it characterized as a "browsewrap" license where the consumer could download the product (the SmartDownload feature of Netscape) without going through an acceptance procedure.[198] The license agreement triggered by the download was visible only if the user scrolled to the next screen. Below the screen used for downloading the user was invited to view and agree to the license agreement before downloading and using the software, but was not told at that point (but rather only

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cases involving electronic delivery. Pursuant to §109(d), a party is located for purposes of this section at its place of business if it has one place of business, at its chief executive office if it has more than one place of business, or at its place of incorporation or primary registration if it does not have a physical place of business. Otherwise, a party is located at its primary residence. For a discussion of choice of law under UCITA, *see* Bruce H. Kobayashi & Larry E. Ribstein, *Uniformity, Choice of Law and Software Sales*, 8 GEO. MASON L. REV. 261, 299-301 (1999).

[193] *See supra* text accompanying note 154.

[194] *See* UCITA, *supra* note 192, §109, Reporter's Note 2.

[195] *See id.* §109(d).

[196] *See id.* §110, Reporter's Notes 2-4.

[197] 2001 WL 755396 (S.D.N.Y. July 5, 2001).

[198] The court applied California law on the issue of contract formation because Netscape's principal offices were in California, the product was designed in California and distributed from a website maintained in Netscape's California offices, citing California's interest in arbitration regarding products created locally by California-based corporations and in whether such a corporation has created a product that violates federal law.

in the license itself) that he had to agree to the license terms before downloading and using the software. The court sharply distinguished cases in which the user had to click the "accept" box before being able to use the product, stating:

> The case law on software licensing has not eroded the importance of assent in contract formation. Mutual assent is the bedrock of any agreement to which the law will give force. Defendants' position, if accepted, would so expand the definition of assent as to render it meaningless. Because the user Plaintiffs did not assent to the license agreement, they are not subject to the arbitration clause contained therein and cannot be compelled to arbitrate their claims against the Defendants.[199]

The court also noted that "[f]rom the user's vantage point, SmartDownload could be analogized to a free neighborhood newspaper, readily obtained from a sidewalk box or supermarket counter without any exchange with a seller or vender. It is there for the taking."[200]

Consistent with this demand for something approaching actual consent, the ABA's Committee on Cyberspace Law has recommended enforcement of non-binding arbitration clauses that call for enforcement of awards pursuant to adequately disclosed choice of forum and law and jurisdictional choices where the consumer has "demonstrably bargained with the seller" or if the contract was made through a bot programmed to reflect the consumer's choices.[201]

Thus, it is not clear that plaintiff will be bound to contractual choice provisions, including those for arbitration, in a web-based transaction, as distinguished from those based on shrinkwrap, unless they are contained in an agreement to which the consumer must explicitly consent before downloading. It is not clear how such a rule can be reconciled with the Gateway cases discussed above. Ripping off a plastic shrinkwrap more comparable to a license notice somewhere on a website than to requiring positive assent to downloading. While software sellers easily can comply with the condition specified in *Specht* – indeed, Netscape itself used an assent procedure similar to the one in *Lieschke* for its main product [202] -- the *Specht* procedure may complicate transfer of cookies because the consumer may have to explicitly assent before the vendor can place a cookie on the surfer's computer.

The biggest risk for merchants involves actions by state attorneys general,

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[199] *Id.* at *8.

[200] *Id.*.

[201] *See Order in Cyberspace*, *supra* note 121 at 1822, 1893. The Committee notes, however, that in light of the many contracting options on the web and the fact that many Internet sellers are small firms, U.S. courts are likely to defer to choice of law and forum contracts that are not unconscionable. *Id.* at 1829, 1832, 1894.

[202] *Specht*, 2001 WL 755396 at *6.

primarily under state consumer fraud statutes.[203] Although these actions would not appear to be constrained by clauses in particular contracts selecting states with less restrictive laws, they do not undercut the case for state rather than federal law. First, unlike private plaintiffs, state attorneys general are subject to political pressure, including those that may arise from merchants' avoiding strict-regulation as discussed below in this Part. Second, and perhaps most important, as discussed in more detail below, federal law not only is unlikely fully to address the problem of state enforcement actions, but may even exacerbate it.

Finally, one commentator has raised questions concerning the constitutionality under the Full Faith and Credit clause of contractual choice to the extent that vendors can choose jurisdictions that otherwise have no relationship to the parties or transaction, as under the proposed revised UCC and UCITA provisions discussed above.[204] There is, however, no case law or policy support for the argument that the Full Faith and Credit clause demands that a state have a relationship with the parties or transaction other than having been selected in the contract. Indeed, this restrictive interpretation of Full Faith and Credit may bring it into conflict with the policies underlying other Constitutional provisions. For example, it arguably conflicts with the policy of the dormant Commerce Clause to the extent that it eliminates a contractual device for eliminating spillovers.[205] Moreover, enforcement of contractual choice of law may be necessary to preserve privacy regulation from invalidity under the First Amendment.[206] Given these competing considerations, in order to preserve an efficient balance regarding choice of law, the Constitution should be applied neither to support nor undermine

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[203] *See* Keith Perine, *States to Weigh In on Privacy*, THE INDUSTRY STANDARD, January 25, 2001, available at www.law.com (discussing actions by state attorneys general and their opposition to federal regulation).

[204] Richard K. Greenstein, *Is The Proposed U.C.C. Choice Of Law Provision Unconstitutional?* 73 TEMP. L. REV. 1159 (2000).

[205] *See supra* note 132.

[206] Some cases have recognized First Amendment limitations on regulating Internet privacy. *See* U.S. West, Inc v. FCC, 182 F.3d 1224 (10th Cir. 1999) (FCC regulation restricting telephone companies' use of customers' personally-identified data unless the customers opted into such use violated the First Amendment because more restrictive than necessary); United Reporting Publ'g Corp. v. California Highway Patrol, 146 F.3d 1133 (9th Cir. 1998), *rev'd sub nom.* Los Angeles Police Dep't v. United Reporting Publ'g Corp., 528 U.S. 32 (1999) (invalidating statute authorizing release of arrestees' addresses for "scholarly, journalistic, political, or governmental" but not commercial purposes because it was "directed at preventing solicitation practices"). These limitations have been strongly defended. *See* Eugene Volokh, *Freedom of Speech and Information Privacy: The Troubling Implications of a Right to Stop People From Speaking About You*, 52 STAN. L. REV. 1049 (2000). However, as Professor Volokh recognizes, *contractual* restrictions on consumer marketing information should survive the First Amendment, including statutory restrictions that the parties can contract around. State mandatory rules can be viewed as default rules to the extent that the parties can avoid them by choice-of-law clauses. By this reasoning, enforcement of such clauses may be essential if facially mandatory restrictions on use of consumer marketing information are to withstand First Amendment attack.

enforcement of contractual choice.

B. AVOIDING NON-ENFORCING JURISDICTIONS

Even if contracting parties cannot be sure that courts will enforce their contractual choice of law or forum, they can avoid giving a non-enforcing or excessively regulating state a jurisdictional predicate for imposing its law, or can reward states with reasonable regulation by investing or paying fees in those jurisdictions. Thus, contractual jurisdictional choice can be made more effective by combining it with physical jurisdictional selection and avoidance. We envision a multistage process involving regulation, contracting and moving in reaction to inefficient regulation and failure to enforce contracts that ultimately can discipline inefficient state attempts to regulate. This process has worked before to constrain inefficient laws, most notably relating to corporations and other business associations and franchise contracts.[207] It is particularly likely to work in the Internet context given the availability of cheap information and the ease and potential mechanization of the contracting process.

First, sellers may be able to block access of their websites at some addresses, including in states that do not enforce choice of law or choice of forum clauses.[208] To the extent that this is fully successful, states would have no basis for exercising jurisdiction under any jurisdiction rule. Even if sellers cannot block their websites from non-enforcing jurisdictions, the targeting tests discussed above[209] may let them avoid jurisdiction in a state if they show that they have taken all available precautions to block access and disclaim the making of an offer there. Sellers who successfully avoid non-enforcing states will, of course, have to forego the benefits of transactions in those states. Thus, a website operator can avoid jurisdiction in a state with regard to consumer marketing information only by not planting cookies on and taking information from computers in that state. But consumers also incur costs if their state's onerous law cuts them off from numerous websites or forces them to go through extra steps in order to access the sites. Consumers may respond either by lobbying against the regulation or by refusing to support consumer groups' efforts in

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[207] *See* Kobayashi & Ribstein, *supra* note 169. For further evidence supporting our hypothesis that firms use jurisdictional choice to avoid oppressive laws, *see* Hylton & Drahozal, *supra* note 174.

[208] Goldsmith & Sykes, *supra* note 116 at 21-22 discuss technology that allows website operators to identify the geographical origin of a user's Internet Protocol address so that they can tailor content to and comply with different jurisdictions' regulations. They note that this technology is more accurate for national origin (99%) than for state origin (80-90%), and that buyers who reside in a regulating state can access a computer with an address in a non-regulating state. *See id.* at 22 (noting that users can frustrate geographical origin technology through America Online's proxy server, Internet anonymizers, and remote telnet and dial up connections). However, this technology is developing and likely to improve, thereby making jurisdictional choice more effective.

[209] *See supra* text accompanying note 147.

favor of the regulation.[210]

Second, firms can minimize the possibility that a state's law will apply by avoiding placing significant assets or headquarters there. Even if states can exercise long-arm jurisdiction over remote sellers, the seller's location is relevant for purposes of general jurisdiction[211] and the enforcement of choice of law and choice of forum clauses. As discussed above,[212] the *Restatement* provides for non-enforcement of contractual choice where the contractually selected state lacks a "substantial relationship" to the parties or the transaction or "other reasonable basis for the parties' choice," or where the chosen law contravenes a "fundamental policy" of a state that has "a materially greater interest than the chosen state" and would be the applicable law under the default choice-of-law rule. The default rule, in turn, looks to such factors as the parties' place of incorporation and place of business.[213] UCITA looks to similar factors in determining the state whose mandatory rules apply.[214] A seller therefore is better able to secure enforcement of choice-of-law or choice-of-forum clauses over the range of its Internet dealings if it has its home office in the selected state.

These rules may marginally influence some seller location decisions. Analogously, firms have generally avoided locating in the states with the most stringent franchise regulation that fail to restrict application of their laws to residents.[215] Also, insurers have shown that they will pull out of states where regulation constrains profits.[216] Because Internet firms can connect their servers to the Internet from any location and their assets consist mostly of highly mobile human capital and intellectual property, states easily can attract Internet companies

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[210] *See* Kobayashi & Ribstein, *supra* note 169.

[211] *See supra* note 137.

[212] *See supra* text accompanying 154.

[213] *See supra* text accompanying note 123.

[214] *See supra* note 192.

[215] *See* Kobayashi & Ribstein, *supra* note 169.

[216] For evidence of the importance of exit as a potential constraint on state regulation, *see* Epstein, *supra* note 107 at 162-5 (discussing the use of exit taxes used to deter the withdrawal of automobile insurance companies from New Jersey and Massachusetts). *See also Aetna Takes off Gloves on Car Insurance*, WALL STREET J., A4, (June 7, 1990) (reporting Aetna's challenge of laws in Pennsylvania and Massachusetts that control its exits from these states). For other examples of regulation-induced exit, *see* WALL STREET J., NW4 (August 16, 2000) (noting exit of health insurance companies from Washington State due to state policies); WALL STREET J. (November 15, 1988) (discussing exit of 40 insurers from California due to Proposition 103 rate rollback); WALL STREET J. (August 10, 1992) (discussing withdrawal of Ohio Casualty Corporation from California Market because of excess regulation and poor underwriting results).

with favorable regulation, and just as easily lose such companies by increasing regulatory burdens.[217]

Firms' location decisions, in turn, have real economic consequences for states' residents who depend on the firms' business, including local lawyers.[218] These residents could be expected to lobby their legislators for rules that attract, or at least do not repel, firms that might be clients or customers, including moderate levels of regulation, narrow application of the regulation, or enforcement of contractual choice.[219] This may counteract lobbying by pro-regulatory groups.[220]

In general, therefore, contractual and physical jurisdictional selection and avoidance can significantly reduce the need for a federal rule. To be sure, contracts alone may not be enough because of non-selected jurisdictions' incentives to enforce local law, and physical avoidance and selection may not alone be enough because of multi-state firms' costs of avoiding large state markets. But the two strategies together can effectively constrain state law. Moreover, even if state competition does not fully constrain inefficient regulation, the relevant question, considered below in Part V, is whether it is likely to produce better laws over time than a federal regime.

It is important to emphasize that the analysis so far in this Part mainly responds to the perceived problem of inefficient state laws resulting from states' excessive exercise of jurisdiction. The analysis suggests that vendors may be able to choose to be governed by laws that are at least not very contrary to their interests. The question of how far states are likely to go in actively competing to provide efficient laws is discussed further below.[221]

C. UNDER-REGULATION, CONTRACTUAL CHOICE AND MARKETS

If courts enforce choice of law and forum contracts, the question arises

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[217] Lawyers, an important interest group, may be influential in persuading states to attract Internet-related business because these firms provide an attractive source of legal business. For a general analysis of lawyers' role in encouraging state competition, *see* Ribstein, *supra* note 156.

[218] It follows from this analysis that courts are wrong not to weigh states' "interest" in the enforcement of contracts that choose their laws against any interest regulating states may have in the enforcement of their laws. For an example of this analytical error, *see supra* note 198.

[219] Enforcement of contractual choice of law therefore could result from interest group pressure, and not necessarily by relying on judges and lawyers others who are immune from those pressures, as Paul Stephan suggests. *See* Paul B. Stephan, *Regulatory Cooperation and Competition - The Search for Virtue*, U. Va. W.P. No. 99-12 (June, 1999), http://papers.ssrn.com/paper.taf?abstract_id=169213.

[220] This tension between pro-regulatory and pro-local-business interests may explain Iowa's waffling regarding enforcement of contractual choice of UCITA. *See infra* note 238.

[221] *See infra* subpart IV(D).

whether electronic commerce, having avoided over-regulation by a multiplicity of states, will be subject to under-regulation because vendors will be able to designate state law that is favorable to them and thereby evade efficient state regulation. In other words, if firms can effectively shop for state law, some critics claim that state legislatures will "race for the bottom" to see who can regulate least.

Choice of law and forum might be said to involve even more serious problems than contracting over other terms because the relevant terms are embedded in the chosen law rather than disclosed directly.[222] It has been argued that sellers, as experts and repeat players have a strong advantage over consumers in choosing the law.[223] Consumers usually cannot justify the cost of hiring legal help, while sellers enter into similar deals with a number of other parties and therefore can afford to invest in legal expertise about various state laws.[224] Indeed, one commentator ridicules the idea that consumers "shop" for law.[225] Similarly, in the corporate context it has been said that states attract incorporation business by exploiting principal-agent problems resulting from the separation of ownership and control.[226] The contrary argument, that corporate law is a “race to the top” disciplined by efficient capital markets,[227] arguably does not apply to Internet transactions in the absence of such of a market.

These arguments might lead non-selected states either to refuse to enforce clickware choice of law or forum clauses or to condition application of another state's law on disclosure and consent procedures that address this problem. Mandating such procedures might significantly reduce consumers' ability to choose among varying levels of state law protection. These arguments also might be used to justify federalizing Internet rules.

However, contractual choice of law and forum in the electronic commerce

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[222] *See* Goldsmith, *supra* note 122 at 1215; Johnson & Post, *supra* note 96 at 1395-1400 & nn 102-03.

[223] *See* Edward J. Janger, *The Public Choice of Choice of Law in Software Transactions: Jurisdictional Competition and the Dim Prospects for Uniformity*, 26 BROOK. J. INT’L L. 187 (2000); William J. Woodward, Jr., *Contractual Choice of Law: Legislative Choice in an Era of Party Autonomy*, 54 SMU L. REV. 697 (2001) (*"Party Autonomy"*); William J. Woodward, Jr., *"Sale" of Law and Forum and the Widening Gulf Between "Consumer" and "Nonconsumer" Contracts in the UCC*, 75 WASH. U. L. Q. 243 (1997).

[224] *See* Woodward, *Party Autonomy*, *supra* note 223 at 741.

[225] *See* Woodward, *supra* note 223 at 257, n. 59 (conjuring a "vision" of consumers with shopping carts "ambling down" grocery store aisles).

[226] *See* William Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

[227] *See* Ralph Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

context does not disadvantage consumers to the extent that the critics have supposed. Although vendors rather than consumers may be the ones who "shop" for law, the market is capable of disciplining vendors' choices in this regard. Some of these arguments already have been discussed for the general electronic context,[228] and now will be applied specifically to contractual choice of law and forum.

First, as already discussed,[229] Internet firms have strong reputational incentives to disclose and not to cheat customers. Lacking bricks-and-mortar storefronts that given assurances to customers, the firms cannot afford to generate suspicion by proposing outlandish legal terms, such as relying on a provision hidden in the contractually chosen law that frustrates buyers' expectations. For example, in the Gateway situation discussed above, Gateway apparently went to pains to explain a change in its arbitration provision to consumers in the magazine Gateway voluntarily sends to its customers as a way of building customer loyalty and goodwill.[230] While fly-by-night vendors may try to get away with legal tricks, these are the firms that are least likely to be concerned about legal sanctions. In any event, the costs of regulating an entire market solely to catch these miscreants may outweigh the benefits.

Second, as discussed above informed buyers protect the uninformed.[231] Because they sell through a single website rather than personalized communications with consumers, web merchants would find it hard to aim different law choices at informed and uninformed consumers. Thus, as long as there are enough knowledgeable consumers in the marketplace, the general price is likely to reflect knowledgeable consumers' awareness of the effect of harmful choice-of-law or choice-of-forum clauses.

Third, it might be argued in response to the last point that there will be very few expert consumers to lead the market because they face high costs of learning about the chosen law or forum. However, consumers have cheap access to many sources of buyer-oriented information about sellers, including third-party ratings services, competitors, consumer magazines and the Internet. For example, a consumer who wants to buy computer or electronics products can view on Cnet.com not only the current prices of various vendors, but also how the vendors' services are rated by a service known as Gomez.com. It may be that such information intermediaries alone cannot be fully relied on to create fully efficient markets, among other reasons because consumers will not pay for accurate information about specific products, advertising-supported services skew recommendations, and the low-

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[228] *See supra* subpart I(C)(1).

[229] *See supra* text accompanying note 67.

[230] *See* Brower v. Gateway 2000, Inc. 676 N.Y.S.2d 569, 574 (A.D. 1998).

[231] *See supra* text accompanying note 70. *See also* Stephan, *supra* note 219 at 41.

marginal-cost nature of the Internet market limits the number of competitors.[232] But their efforts are supplemented by the general news media that reports on legal developments such as vendor misuse of choice-of-law clauses that are of general interest to consumers. In particular, litigated cases can generate publicity and work together with reputational constraints to deter sellers from using oppressive choice-of-law clauses.[233] Because the Internet market circulates so much seemingly obscure data, it has some of the characteristics of efficient capital markets, which commentators have argued discipline corporations' choice of incorporating state.[234] This market does not necessarily have to be fully efficient[235] in order to provide a suitable alternative to costly and imperfect regulation.

Fourth, contractual choice of law and forum may not be very different from many other highly technical aspects of products such as computers, software and electronic products. One might argue that important characteristics of a product, such as a computer's clock speed, a television's scanning mechanism or countless other product characteristics are beyond the understanding of most consumers. However, no one has suggested special federal regulation to ensure that consumers are adequately informed about these features. Moreover, these details provide further evidence of the information efficiency of Internet markets, since computer and electronics magazines, websites and so forth have been effective in broadly disseminating this sort of information.

Finally, even if markets do not adequately protect consumers from oppressive choice-of-law and forum clauses, it is important to keep in mind that these clauses are subject to political as well as market discipline in the sense that political entities rather than private parties design the relevant choices. Thus, even if vendors could get away with oppressive clauses in the product market, they may still be unable to find states that provide the low level of regulation they seek. A state

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[232] *See* Mark R. Patterson, *On the Impossibility of Information Intermediaries*, Fordham Law and Economics Research Paper No. 13 (July, 2001), available at http://papers.ssrn.com/abstract=276968. *See also*, Woodward, *Party Autonomy*, *supra* note 223 at 762 (noting that "there are no consumer groups or other services that give parties to form contracts meaningful information through which they can easily compare the terms of the form contracts").

[233] One author notes that Gateway continued selling its computers with arbitration clauses without apparent damage to its reputation even after these clauses were subject to the widely publicized litigation discussed above. *See* Woodward, *supra* note 223 at 762, n. 287. Woodward produces no facts about the effects or non-effects on Gateway's sales, and does not explain why a non-effect, if that was the case, would simply show that consumers were not concerned about the term.

[234] *See supra* text accompanying note 227.

[235] Patterson's article draws its title from Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393 (1980) (arguing that capital markets cannot be strong-form efficient and still offer incentives to produce information that create the condition of efficiency).

legislature that fails adequately to regulate consumer marketing information lets merchants harm users who live in the state. Internet users can employ the same information and sophistication that they use in the product market in making political choices, and the pro-regulatory coalition of consumer groups and big firms will have some influence at the state level. These interest groups also influence state attorneys general, elected officials who have ample incentives to bring highly publicized enforcement actions against Internet firms.[236]

Of course, the above arguments may fail to persuade all states to enforce contractual choice.[237] Pro-regulatory interest groups may be able to inhibit enforcement of contractual choice or other forms of exit up to the point that vendors' losses provoke them to completely avoid offending jurisdictions or lobby effectively to change the law. This may explain Iowa's "bomb shelter" provision in its Uniform Electronic Transactions Act denying application of another state's law pursuant to a choice of law clause if UCITA is the chosen law.[238] This equilibrium may be less efficient than one in which choice-of-law clauses are enforced everywhere. But the potential for state resistance actually supports a state rather than federal approach to regulating the Internet to the extent that it constrains excessive laxity. By contrast, federal legislation may lock in inefficiently lax or excessively rigorous regulation.

D. THE EMERGENCE OF EFFICIENT STATE LAW

The discussion so far shows that state regulation of the Internet coupled with enforcement of contractual choice of law and forum at least enhances efficiency by enabling firms to exit excessive state regulation. This means that the least efficient state laws will govern fewer parties and transactions and the more efficient state laws will govern more parties and transactions. However, without change in the law, contractual choice of law might do no more than help affected parties make the best of a bad lot. If individual states lack adequate incentives to compete to supply efficient law, this strengthens the argument for uniform or federal law. This Section discusses whether contractual choice of law has the additional effect of causing the laws themselves to become more efficient. Subsection 1 considers whether state legislators and regulators have the political incentives to respond to these competitive pressures by enacting more efficient laws. Subsection 2 discusses whether development of efficient state laws will be inhibited by lock-in of existing

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[236] *See supra* note 203 and accompanying text.

[237] *See* Janger, *supra* note 223 at 196 (noting that "jurisdictions that have many licensees and few licensors, or a strong tradition of consumer protection, will be unlikely to adopt the location of licensor rule").

[238] *See* Iowa St. Section 554D.104.4 (2000). Iowa is, however, reconsidering its resistance to contractual choice of UCITA. The legislature swiftly repealed the "bomb shelter" provision effective July 1, 2001, explicitly stating that it was considering whether to adopt UCITA. *See* Iowa Acts 2000 (78 G.A.) ch. 1189, Section 32 (approved May 15, 2000). The following year it delayed the repeal to 2002. *See* Iowa Legis., H.F. 569, Section 1 (approved April 16, 2001).

standards.

1. States' ability and incentives to compete

It is not clear what states have to gain from passing innovative laws dealing with electronic commerce. This contrasts with Delaware's incentive to attract substantial incorporations, where franchise fees of large corporations form a significant fraction of the state budget.[239] Moreover, even if it is in a *state's* interest to provide a suitable environment for electronic commerce, it is not clear that individual state *legislators* have incentives, resources and expertise to compete.[240] Even if the state as an entity would gain by attracting users of its law, public choice theory assumes that state lawmakers act in their own, rather than the state's, interests by maximizing the rents they receive from interest groups. Legislators who can earn support from trial lawyers, pro-consumer groups and others by brokering changes in mandatory rules may lack incentives to sponsor enabling rules. Even if politicians have some incentive not to provide inefficient laws, they may have little incentive to innovate since other jurisdictions easily can copy their successes while the innovators suffer the embarrassments and loss of rents from their failures.[241]

There are, however, several reasons why states might actively compete to supply efficient laws for electronic commerce. First, lawyers, who are one of the most influential interest groups because they are highly organized and know the law, have incentives to lobby for such laws. Because of firms' ability to contract for law and forum, efficient laws would attract both litigation and planning business to enacting states.[242] Indeed, there is significant evidence that lawyers played an active

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[239] *See* Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985).

[240] *See* Douglas J. Cumming & Jeffrey G. MacIntosh, *The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law*, 20 INT. REV. L. & ECON. 141 (2000); Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?* 9 J. LEGAL STUD. 593 (1980) (observing that legislators may be unable to capture benefits from engaging in the competition because other jurisdictions easily can free-ride on their efforts by copying successful legislation); Henri I.T. Tjiong, *Breaking the Spell of Regulatory Competition: Reframing the Problem of Regulatory Exit*, Max-Planck Project Group Preprint No. 2000/13 (August, 2000), http://papers.ssrn.com/paper.taf?abstract_id=267744 (arguing that there is no political "feedback mechanism" to translate firm mobility into optimal regulation).

[241] *See* Rose-Ackerman, *supra* note 240.

[242] For a fuller discussion of lawyers' ability and incentives to lobby for efficient laws, *see* Larry E. Ribstein, *Lawyer Licensing and State Law Efficiency*, http://hal-law.usc.edu/cleo/papers/alea/Ribstein.pdf (April 9, 2001). *See also* Larry E. Ribstein, *Delaware, Lawyers and Choice of Law*, 19 DEL. J. CORP. L. 999 (1994), reprinted in 37 CORPORATE PRACTICE COMMENTATOR 151 (1995); Jonathan R. Macey & Geoffrey Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987) (discussing lawyers' role in corporate context).

role in spurring state competition to supply limited liability company statutes,[243] and that this competition has produced efficient state laws.[244]

Second, state legislators can earn political credit, which can generate funds, votes and other rents, by making their states attractive centers for business and technology generally and electronic commerce in particular. These industries attractively combine high wages and low pollution. Moreover, they are subject to an increasing returns phenomenon whereby the presence of more skilled workers attracts more firms and reduces the costs of skilled labor.[245] Many areas of the country might seek to build on their inherent advantages in attracting these industries, such as the presence of prestigious universities, by offering the appropriate "legal infrastructure."[246] For example, Virginia, which has aggressively sought to become a hub of high-tech or Internet activity, was the first state to enact the generally pro-seller Uniform Computer Information Transactions Act.[247]

This does not necessarily suggest that all or even many states will have an incentive to offer innovative laws on electronic commerce.[248] Even states that seek to attract high-technology companies can do so by, in effect, free-riding on other states' efforts by copying their laws or by enforcing contractual choice of law and forum to permit local firms to take advantage of other states' laws. But as long as a few states have incentives to attract business by innovating, this may be enough to spur development of efficient laws even if other states only copy or enforce these

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[243] *See also* Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, But Heading Where?* 45 SYRACUSE L. REV. 1193 (1995).

[244] *See* Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs,* 73 WASH. U. L. Q. 369 (1995).

[245] For a recent discussion and application of this theory, *see* Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete,* 74 N.Y.U. L. REV. 575 (1999).

[246] *Id.* (discussing the role of the state's law on enforcement of non-competition agreement and its effect on local diffusion of knowledge among skilled workers).

[247] *See* Va. Code Ann., tit. 59.1-501.1, et. seq. Virginia has offered other inducements to Internet firms, including through a long-arm jurisdiction law designed to benefit local Internet service providers such as AOL (*see supra* note 139). *See also supra* text accompanying note 153 (discussing Virginia proposal to permit website domestication). Maryland's subsequent version of UCITA, which became effective first, modifies UCITA, most importantly by partially excluding consumers from some provisions as to warranty modification. *See* Maryland §406(i) and (j).

[248] Among other things, the overall effects of "legal infrastructure" may be complex, because the same features that increase states' payoffs from becoming centers of electronic commerce also induce firms to remain in established centers and inhibit other states from entering the market. This "lock-in" may or may not be an example of the "network externalities" phenomenon discussed immediately below.

statutes and other states do not compete at all.

2. Network externalities and lock-in

State-by-state lawmaking arguably can be inefficient because of the importance of "networks" of users that can arise from adoption of a national standard. For example, a statutory disclosure rule relating to terms of software licenses might require that the disclosure be where the buyer is likely to see it -- e.g., "in close proximity to a description of the computer information, or to instructions or steps for acquiring it" or "in a prominent place on the site from which the computer information is offered."[249] Although a legislature cannot practicably go much further in website design, the market can provide useful information in the form of vendors' actual practices in complying with the rule. More generally, the parties' transaction and information costs in complying with a statutory standard may depend on the size of the network of users of this standard that generates these forms and practices.

The development of a network involves a potential externality. Each vendor or consumer who adopts a standard considers only its own benefits from the adoption, and not the benefits conferred on others who use the standard. As a result of this externality, although society may gain from a user's move to a new network, the old network may be "locked in."[250] Commentators have argued that there are similar effects in connection with contracts and statutes.[251] For example, Michael Klausner suggests that the long dominance of Delaware law might be due to lock-in effects rather than the superiority of the Delaware regime.[252]

"Network externalities" may affect the development of state laws dealing with electronic commerce. Standards may not develop under individual state laws,

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[249] *See* UCITA §209, discussed in Kobayashi & Ribstein, *supra* note 192 at 265-66.

[250] For general discussions of network externalities and lock-in see Joseph Farrell & Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 RAND J. ECON. 70, 71-72 (1985) (characterizing the problem as one of excess inertia); Michael L. Katz & Carl Shapiro, *Systems Competition and Network Effects*, J. ECON. PERSP., Spring 1994, at 93; Michael L. Katz & Carl Shapiro, *Technology Adoption in the Presence of Network Externalities*, 94 J. POL. ECON. 822 (1986); Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424 (1985).

[251] *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or, "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997); Marcel Kahan & Michael Klausner, *Antitakeover Provisions in Bonds: Bondholder Protection or Management Entrenchment?*, 40 UCLA L. REV. 931 (1993); Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior, and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Tara Wortman, Note, *Unlocking Lock-In: Limited Liability Companies and the Key to Underutilization of Close Corporation Statutes*, 70 N.Y.U. L. REV. 1362 (1995).

[252] *See* Klausner, *supra* note 251.

or if they do develop they may become locked in because they determine the technological architecture of web commerce, or because a new standard would forego the benefits of case law that interprets the existing standard. For example, if a first-mover state becomes an early "Delaware" of the Internet and provides for particular default rules, contracting mechanisms or disclosures, all clarified by interpretive case law, the many firms that select this state's law will design their web pages accordingly. Consumers, for their part, may expect vendors to use particular standardized procedures. Thus, even if a new standard is more efficient than an existing one, network externalities may prevent the standard from developing a large enough network of users to generate interpretive devices or to induce vendors and consumers to change their procedures or configurations. This phenomenon, for example, might prevent widespread adoption of the P3P protocol.[253] In light of these problems, the law regulating electronic commerce arguably should be provided by a centralized, expert body rather than by the first state law that happens to become widely accepted.

The network externalities theory is, however, a questionable basis for abandoning the process of state-by-state lawmaking because of the many uncertainties about how and when the theory operates.[254] First, even if an inefficient standard has developed, lock-in is a problem only if users' costs of moving to a new standard are high enough to outweigh their present discounted benefits under the new standard. It is not clear under what conditions this will be the case. Second, users' failure to move to the new standard is likely to be inefficient only if neither users nor any third party will internalize the benefits of doing so. Again, it is not clear when this will occur. Among other things, vendors themselves may benefit from sponsoring a new standard, as in the case of the P3P protocol. Third, even if lock-in of inefficient standards occurs, this does not in itself justify using a centralized lawmaking process since lock-in may occur under that process as well. Thus, the question is whether the centralized process is more likely to lead to an efficient result than a standard arrived at by a decentralized process.[255]

Given these theoretical uncertainties, it would be prudent at least to have some data on network externalities in the context of state lawmaking before using this theory to support relying on centralized lawmaking. Data on an analogous issue

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[253] *See supra* text accompanying note 101 (discussing P3P).

[254] For criticisms of the theory as applied to products and services see S. J. Liebowitz & Stephen E. Margolis, *The Fable of the Keys*, 33 J.L. & ECON. 1 (1990). *See also* S. J. Liebowitz & Stephen E. Margolis, WINNERS, LOSERS, AND MICROSOFT: COMPETITION AND ANTITRUST IN HIGH TECHNOLOGY (1999) (showing evidence that Microsoft's victory in software markets is due to the superiority of their products rather than network externalities); S. J. Liebowitz & Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, J. ECON. PERSP., Spring 1994, at 133. For criticisms of the application to contracts and statutes see Clayton P. Gillette, *Lock-In Effects in Law and Norms*, 78 B.U. L. REV. 813 (1998); Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 562-86 (1998).

[255] *See infra* text accompanying note 312.

supports the opposite conclusion. Our study of lock-in in the context of state laws regarding statutory business forms showed evidence that lock-in was not a significant factor in explaining choice of form.[256] In contrast, a broad federal solution that preempts state law eliminates competition, in effect ensuring that parties will be locked in to the mandatory parts of the regulation.[257]

V. EVALUATING THE FEDERAL ALTERNATIVE TO STATE LAW

As discussed above in Part III, an argument in favor of federal regulation of electronic commerce is that states will tend to over-regulate because ambiguities in the law of jurisdiction and conflict-of-laws give states substantial reach. As discussed above in Part IV, although enforcing contractual choice of law and forum addresses this over-regulation problem, it does not immediately or completely solve the problem since state courts will retain some ability and incentive to override contractual choice of law and forum.[258] But this does not necessarily justify a federal solution because of the Nirvana fallacy: the inadequacies of state law must be compared with those of federal law. This Part shows that federal law is unlikely to eliminate, or even to significantly address, over-regulation of electronic commerce. Subsection A discusses problems regarding preemption of state by federal law. Subsection B discusses inherent problems with any federal law that may be adopted in this area. Finally, Subsection C shows that actual adoption of federal law is not only premature, but also unnecessary at this time because the *threat* of federal regulation may constrain inefficient state law.

A. INCOMPLETE PREEMPTION

The biggest problem is that federal regulation of aspects of electronic commerce may not preempt all state law on the subject. Many of the federal privacy bills that have been introduced do not purport to preempt state law, particularly including state actions based on common law fraud or tort or on general consumer fraud statutes.[259] To the extent that preemption is unclear, plaintiffs' lawyers and

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[256] *See* Larry E. Ribstein & Bruce H. Kobayashi, *Choice of Form and Network Externalities*, 43 WILLIAM & MARY L. REV. ___(2001).

[257] Those advocating federal law questionably assume that this will produce a better solution than the decentralized state solution. Analogously, commentators have questioned whether antitrust regulations should be used to alter market outcomes that resulted in choice of a dominant standard. *See* Liebowitz and Margolis, *Winners*, *supra* note 254 at 266-7. In both cases, government intervention involves substitution of a federally imposed outcome for a more decentralized one -- either by suppressing potential competition or by inducing competition against a dominant standard. In both cases, the federal standard may increase costs and reduce efficiency as compared to the market equilibrium.

[258] *See supra* text accompanying note 237.

[259] Current bills include 2001 U.S. H. 347 (no preemption); 2001 U.S. H. 89 (Act supersedes State law to the extent that it establishes a rule of law applicable to an online privacy action that is

state regulators can be expected to exploit the gaps. For example, the Gramm-Leach-Bliley financial overhaul act, which does not preempt state law, but is subject to the Fair Credit Reporting Act, which does preempt, has not stopped state legislators from passing state privacy laws relating to third-party information firms.[260] Moreover, in the absence of preemption federal law could even multiply regulatory burdens by imposing stringent disclosure requirements that might give rise to misleading statements that, in turn, trigger state fraud remedies.

Although federal laws theoretically could purport to preempt all relevant state law, this would be extremely difficult. In the first place, every state has general law that may apply to electronic commerce, including sales law, the common law of tort, privacy regulation, and regulation of deceptive transactions. It may not be clear how this law relates to or conflicts with federal regulation.[261]

Second, even if complete preemption were technically possible, it is politically infeasible because of the interest groups allied against preemption. These include, of course, state regulators, particularly including state attorneys general, acting through the National Association of Attorneys General, and consumer groups. Even without explicit interest group opposition, Congress would be unlikely to invade such traditional areas of state legislation such as regulation of fraud unless there was a strong constituency supporting such invasion.[262]

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inconsistent with State law, but does not preempt fraud). Two other bills contain broad preemption of state law: 2001 U.S. H. 237 ("No state or local government my impose liability … in connection with an activity or action described in this Act that is inconsistent with, or more restrictive than, the treatment of that activity or action under this section."); U.S. S. 1055 ("provisions of this title shall supersede any statutory and common law of States and their political subdivisions", but allowing state enforcement of section.). In a review of bills pending in 2000, only two even purport to preempt fraud. *See* 1999 U.S. S. 2063 (preempting "[s]tate or local law regarding the disclosure by providers of electronic communication service or remote computing service and operators of Internet Web sites of records or other information covered by this subsection"); 1999 U.S. S. 2928 (providing that "[n]o State or local government may impose any liability for commercial activities or actions by a commercial website operator in interstate or foreign commerce in connection with an activity or action described in this Act that is inconsistent with, or more restrictive than, the treatment of that activity or action under this section"). For examples of bills that do not preempt state fraud remedies, *see* 1999 U.S. H. 5430; 2001 U.S. H. 89, 1999 U.S. S. 809; 1999 U.S. H. 3560; 1999 U.S. S. 2606; 1999 U.S. H. 4059, 1999 U.S. H. 2882; 1999 U.S. H. 313.

[260] *See* 5 BNA ECOMMERCE AND LAW REPORT, 334, 336 (April 5, 2000). See also HIPPA, *supra* note 2 at Part 160.202, 203(b) (allowing states to enforce "more stringent" privacy laws).

[261] For a recent example of the complexities of the preemption issue, *see* Geier v. American Honda Motor Company, Inc., 529 U.S. 861 (2000) (holding that although tort action for defective design for failure to equip car with driver's side airbag was not precluded by express preemption provision of National Traffic and Motor Vehicle Safety Act but it was preempted under general preemption principles because it conflicted with federal standard requiring driver's side airbags in some but not all 1987 cars).

[262] *See* Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward A Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265 (1990) (arguing that

B. INHERENT PROBLEMS WITH FEDERAL LAW

Apart from the preemption problem, federal law dealing with electronic commerce might be even more inefficient than forcing firms to comply with the most rigorous state law in the absence of federal law. First, as discussed above in subpart II(A), the resulting law might end up favoring influential pro-liability interest groups such as power-seeking consumer groups and trial lawyers at the expense of low-margin operators, potential new entrants and individual consumers. Even large global electronic commerce firms might favor a strong federal law. Privacy advocates are pushing for globalization of privacy norms,[263] and European countries already mandate stringent fair information practices.[264] Although U.S. firms can try to avoid foreign regulation through choice-of-law and choice-of-forum clauses, blocking websites from forum screens, and avoiding locating assets in foreign jurisdictions,[265] these maneuvers may not be successful. Blocking may not be fully effective, international law limits enforcement of a choice-of-forum clause in a consumer contract,[266] and wholly avoiding foreign jurisdictions constrains U.S. firms' global competitiveness. Thus, U.S. firms may be tempted to tailor their policies to foreign laws rather than fight them, and then seek federal regulation that conforms to European standards so that they can compete on a level playing field with U.S. firms that do not do business internationally.

Second, even if the federal law appears benign, it may be inefficient in the hands of the federal agency that administers it. Bureaucracies can promote expansionist agendas through aggressive interpretation of the statute.[267] One

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federal legislators have incentives to refrain from legislating in area of law if they would lose more support than they would gain from acting, as where federal regulation would dissipate a substantial state capital investment in regulation).

[263] *See generally*, Reidenberg, *supra* note 9.

[264] These are based on the OECD standards, *supra* note 94.

[265] As to the latter move, *see* David Pringle, *Some Worry French Ruling on Yahoo! Work to Deter Investments in Europe*, WALL ST. J., November 22, 2000 at B2, 2000 WL-WSJ 26617732 (quoting website operator as stating that "companies are going to ensure that they have no assets in Europe to reduce the chances of being successfully sued"). This move may be effective given the lack of a "full faith and credit" clause in the foreign context. *See* Michael Whincop and Mary Keyes, *The Recognition Scene: Game Theoretic Issues in the Recognition of Foreign Judgments*, 23 MELB. U. L. REV. 416, 422 (1999).

[266] Such contracts may be enforced only 'to the extent only that it allows the consumer to bring proceedings in another court." *See* Hague Conference on Private International Law, *Preliminary Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters*, art 4, Paragraph 7(3)(b), available online at http://www.hcch.net/e/conventions/draft36e.html (adopted by the Special Commission on Oct. 30, 1999).

[267] *See, generally*, William Niskanen, Bureaucrats and Politicians, 28 J. L. & ECON. 617, 635 (1975) (discussing overspending by government bureaus). This problem may be exacerbated by statutes in which multiple agencies have oversight and enforcement responsibility. *See* Gramm-Leach-

technique is to promote self-regulation as a way of avoiding government regulation, and then apply federal remedies based on violation of voluntarily adopted policies, as the FTC has done with respect to consumer marketing information.[268]

Third, federal law can have unpredictable effects because of litigators' efforts to apply it to new technologies. For example, litigators have attempted to apply older laws relating to interception of electronic communications and unlawful access to stored communications to cases involving placing of cookies on consumers' computers.[269]

Fourth, even if federal law does preempt state law and is relatively innocuous, it might still have perverse effects because the existence of broad federal regulation discourages the development of state law. A similar phenomenon has been observed, for example, with regard the effect of federal bankruptcy law on state debtor-creditor law.[270]

Recently enacted federal privacy laws provide a preview of what federal regulation of the Internet might entail. For example, the Children's Online Privacy Protection Act (COPPA), adopted in 1998,[271] as interpreted by the FTC's 1999 rules,[272] requires website "operators" or online services "directed to children under 13," or who have actual knowledge that the person from whom they seek information is a child, to comply with strict notice and parental consent requirements

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Bliley, *supra* note 2 (delegating rulmaking and enforcement authority to the FTC, Treasury Department, Comptroller of the Currency, Federal Reserve, FDIC, NCUA, and SEC).

[268] *See FTC Press Release, FTC Announces Settlement with Bankrupt Website Toysmart.com Regarding Alleged Privacy Policy Violations*, (July 21, 2000), available online at www.ftc.gov/opa/2000/07/toysmart2.htm (announcing settlement of charges that toysmart.com violated Section 5 of the FTC act when it violated its own privacy policy never to share customer information with third parties. *See also* discussion in note 11, *supra. But see* Steven Hetcher, *The FTC as Internet Privacy Norm Entrepreneur*, 53 VAND. L. REV. 2041 (2000) (arguing that the FTC has attempted to guide self-regulatory efforts through regulation).

[269] *See* Supnick v. Amazon.com, Inc., 2000 WL 1603820 (W.D.Wash., May 18, 2000) (certifying class action based on 18 U.S.C. §§2510-2522, relating to interception of electronic communications, and *id.* §2701, relating to unlawful access to stored communications).

[270] *See* David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471 (1994) (arguing that federal law has "vestigialized" state law).

[271] *See* COPPA, *supra* note 3. Some have suggested that the provisions of COPPA be expanded to apply to all collection of information. For a discussion of this issue, *see* Cate, *supra* note _, at 63.

[272] Federal Trade Commission, Children's Online Privacy Protection Rule, Final Rule, 16 C.F.R. Part 312, 64 FED. REG. 59,888 (Nov. 3, 1999).

before collecting and disclosing individually identifiable information.[273] The application of this Act's burdensome requirements is potentially quite broad despite the actual knowledge requirement since sites may have to collect age information from users to avoid appearing to evade the rule.[274]

Congress also has regulated privacy of particular types of information. Under Gramm-Leach-Bliley,[275] financial institutions must "clearly and conspicuously" disclose privacy policies to consumers "at the time of establishing a customer relationship and not less than annually during the continuation of such relationship."[276] Gramm-Leach-Bliley has resulted in the costly mailing of billions of privacy notices, not just once but annually whether or not firms change their policies or contemplate further disclosure of information.[277] The Act applies to "any information" provided to or obtained by a financial institution during a transaction or attempt by a consumer to obtain a financial product or service, either on or off-line.[278] It applies not only to financial institutions but also to "other persons," such as lawyers, who receive protected information from a financial institution.[279] HIPPA[280] regulates privacy of health information. HIPPA regulations regarding

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[273] *See* Federal Trade Commission, *How to Comply with Children's Online Privacy Protection Rule*, available at http://www.ftc.gov. Individually identifiable information includes names, e-mail or home addresses, telephone numbers, and any other information (e.g., interests or hobbies collected through cookies) when tied to individually identifiable information. The FTC rule requires those covered by the act to post prominent links to a notice describing what information will be collected and how it will be used, requires parental consent, including some method by which parents can review and request deletion of information collected, and prohibits conditioning use of the website on providing more information than is reasonably necessary. *See* FTC Rule, *supra* note 272. The parental consent requirement depends on how the website will use information collected. The most stringent requirements are imposed when a site wishes to collect and disclose information to third parties, in which event the website must obtain parental consent by telephone contact, presentation of valid credit card information, e-mail with a digital signature, or a printed copy of the parents consent.

[274] *Id.* (noting that failure to collect such information may be used as evidence of evasion of COPPA by the site).

[275] *See* Gramm-Leach-Bliley, *supra* note 2.

[276] *See id.* § 503(a).

[277] *See* Cate, *supra* note 6 at 33, 53.

[278] 12 C.F.R. §§ 40.3(o), 216.3(o), 332.3(o), 573.3(o).

[279] *See* Federal Trade Commission, *Privacy of Consumer Financial Information*, Final Rule, 16 C.F.R. Part 313, 65 Fed. Reg. at 33647 (May 24, 2000).

[280] *See* HIPPA, *supra* note 2.

consent are extremely complex and costly.[281] The regulations require notice even where collection of information is obvious, when no further use of information is intended, and when the subject of the information is deceased.[282] More importantly, these rules' costly disclosure requirements can deter medical research.[283]

The point of reviewing these laws is not to demonstrate that these or other federal law are inefficient, but rather to emphasize that the supposed excesses of state law should be compared to a realistic view of the burdens imposed by federal law. The main difference between federal and state law is that federal laws like those discussed immediately above are not easily avoided and do not accommodate experimentation or contextual variation.

C. WHEN SHOULD CONGRESS REGULATE THE INTERNET?

If, contrary to the analysis in this article, state law proves inadequate to the challenge of regulating electronic commerce, then federal regulation ultimately may be efficient. The point of this article is that federal regulation is inefficient at this early stage in the history of electronic commerce given the substantial issues that have not been resolved, the rapidly developing technology in the area, and the potential for evolution of state law.

It is important to note in this regard that, even without actual federal regulation, the *threat* of federal preemption may be significant in constraining inadequate or excessive state regulation. This threat of takeover by a broader jurisdictional authority can be viewed as a "vertical" dimension of jurisdictional competition.[284] Indeed, the threat of preemption contributes to a presumption that state regulation is efficient.

VI. THE UNIFORMITY ALTERNATIVE TO CONTRACTUAL CHOICE

Uniform state laws theoretically could address the potential problem of over-regulation of electronic commerce by multiple state laws.[285] Specifically, a uniform lawmaking body such as the National Conference of Commissioners on Uniform

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[281] *See* Cate, *supra* note 6, at 54

[282] *Id.*

[283] *Id. See* also text accompanying notes 43 and 44 (discussing deterrent effect of disclosure in context of medical research).

[284] *See* Albert Breton and Pierre Salmon, *External Effects of Domestic Regulations: Comparing Internal and International Barriers to Trade*, 21 INT. REV. L. & ECON. 135 (2001).

[285] For a general discussion of uniformity in this area, *see* Kobayashi & Ribstein, *supra* note 192.

State Laws could propose a law that is then adopted by all of the states. The question is whether this approach would be more likely to lead to efficient laws than contractual choice of state law and federal law. Subparts A through C discuss costs and benefits of uniform laws. Subpart D discusses an alternative approach to uniformity based on contractual choice of law.

A. BENEFITS OF UNIFORM LAWS

Uniform laws offer many of the advantages of federal law. First, they eliminate the problems of determining the applicable law and evasion of state regulation. Second, they overcome state legislators' potential lack of incentives and ability to enact innovative legislation. Third, if the states coordinated around a uniform law, presumably the law would reflect overall costs and benefits in all states and not just individual enacting states. The problem, of course, is that legislators would have an incentive not to adopt a uniform law that restricted their freedom, so that uniform laws are unlikely to deal effectively with the spillover problem.[286] Fourth, a uniform law can contribute to the development of a network of cases and privately developed forms and devices that aid interpretation and application of specific statutory terms.[287] These include issues concerning assent to shrinkwrap licenses, the standard for merchantability of computer software, mechanisms of pre-transaction disclosure of licenses, and standards for electronic self-help enforcement of licenses.

B. COSTS OF UNIFORMITY

Although uniformity of state laws on software sales may have some benefits, it also has potential costs. First, as with federal law, a uniform law imposes a single, top-down solution in a rapidly developing area where there are many questions as to the right approach. Indeed, uniform state laws may be even less flexible and adaptive than federal law because of the significant time involved in the NCCUSL revision process and during state adoption of the revised law, during which time uniformity must be balanced against the need for change. Where there is preexisting uniformity, as where jurisdictional competition has produced spontaneous uniformity, the promulgation of a uniform act that is not widely adopted can actually reduce uniformity.[288]

Second, the uniform lawmaking process does not take into account varying costs and benefits of uniformity among different types of provisions. For example, uniformity may have more value in mass-market transactions where there is a need

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[286] *See* Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569, 577-81, 592 (1998).

[287] *See* Kobayashi & Ribstein, *supra* note 192 at 273-74.

[288] *See* Ribstein & Kobayashi, *supra* note 114 at 188-93 (1996) (showing data on states' adoption of amended uniform law proposals).

for standardization and minimizing per-transaction costs than in transactions that are likely to occur with customized bargaining. Nevertheless, the uniform lawmaking process promotes uniform adoption of entire laws.[289]

Third, uniform laws may be inferior to contractual choice of law as a solution to diverse state laws. Even if identical laws apply across the states to similar transactions, judicial interpretations may vary. Moreover, states are likely to adopt at least subtle variations, as is already the case with UCITA,[290] and states have different mandatory laws that apply outside the scope of the uniform statute.[291] In contrast, contractual choice of law and forum enables the parties to determine in advance the entire law and set of judicial decisions that will apply to their transaction.

C. THE UNIFORM LAWS PROCESS

The uniform lawmaking process has many defects that may prevent it from developing efficient law.[292] Because uniform lawmaking reflects the interests and views of uniform legislators and representatives from various interest groups that seek to influence the process, it is no more likely to reflect "public" interest than any legislature. These observations clearly apply to UCITA, uniform lawmakers' main effort to address electronic commerce.[293].

First, uniform lawmakers have an interest in maximizing the states' adoption of their proposals, and therefore are likely to craft their proposals to achieve this result. Thus, NCCUSL will pay close attention to groups that can influence enactment in states,[294] and try to broker compromises that lead to unclear rules.[295]

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[289] *Id.* at 141, n. 32.

[290] *See supra* note 247 (discussing Maryland and Virginia laws).

[291] *See* UCITA, *supra* note 192, § 105(c) (providing that UCITA is subject to contrary mandatory laws).

[292] *See* Kobayashi & Ribstein, *supra* note 192; Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); Ribstein & Kobayashi, *supra* note 288; Larry E. Ribstein & Bruce H. Kobayashi, *Uniform Laws, Model Laws and Limited Liability Companies*, 66 U. COLO. L. REV. 949 (1995); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1994); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783 (1994).

[293] *See* Kobayashi and Ribstein, *supra* note 192.

[294] Larry T. Garvin, *The Changed (and Changing?) Uniform Commercial Code*, 26 FLA. ST. U. L. REV. 285, 359-60 (1999) (also noting the potential impact on drafters of focused interest group criticism of proposed laws); Janger, *supra* note 286; Ribstein & Kobayashi, *supra* note 288 at 142.

[295] *See* Ribstein & Kobayashi, *supra* note 292, at 975-79 (discussing ULLCA dissolution provisions).

NCCUSL is unlikely to be very effective in reforming the law because it will be reluctant to adopt proposals that states will shun.[296] Because the uniform law process depends on states' cooperation, it is unlikely significantly to constrain states' adoption of legislation that has local benefits but exports costs to other states.[297]

Second, the uniformity process is particularly susceptible to interest group influence. Because uniform legislators lack even the modest resources that state legislators have for investigating interest group claims,[298] and because as discussed immediately below a uniform law proposal may have an impact on state legislators, some interest groups may have an even greater incentive to lobby at the uniform lawmaking level than they would in individual state legislatures. Also, NCCUSL works through lengthy drafting committee meetings held all over the country in which it is costly for lobbyists to participate.[299] UCITA, in particular, involves a specialized area about which uniform lawmakers may not be well informed, and in which several interest groups had strong incentives to lobby, such as software manufacturers, sellers and users.[300]

Third, reformers, who may be no better able than interest groups to speak for the "public" interest, also can have their say in the uniform lawmaking process. UCITA involved a battle between the American Law Institute who sought strong protections for consumers, and the more practical-minded lawyers and politicians associated with NCCUSL who relied on traditional notions of unconscionability and consumers' self-help rights, such as to obtain a full refund before using the product if they object to terms of a shrinkwrap license.[301]

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[296] *See* Janger, *supra* note 286, at 585-86.

[297] Some argue that states have incentives to adopt uniform laws that restrain their own ability to export costs in order to avoid costs imposed on them by other states. *See* Larry Kramer, *Rethinking Choice of Law*, 90 COLUM. L. REV. 277, 314 (1990) (noting states' incentives to act reciprocally in deciding choice of law issues). However, legislators in many situations may lack incentives to act reciprocally. *See* Ribstein & Kobayashi, *supra* note 288, at 140.

[298] *See* Garvin, *supra* note 294 at 354 n.403 (noting the empirical deficiency in the drafting process); Janger, *supra* note 286, at 585-86 (noting possibility of interest group capture of uniform lawmakers on issues requiring technical expertise); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743, 770-73 (1993).

[299] *See* Garvin, *supra* note 294, at 353 (noting the difficulties presented by drafting in committee meetings and recommending drafting by email and computer bulletin board); Janger, *supra* note 286, at 584-86 (noting that privacy of uniform lawmaking process is conducive to interest group influence).

[300] The competition among groups suggests that UCITA could yield vague compromises. *See* Schwartz and Scott, *supra* note 292.

[301] *See* Kobayashi & Ribstein, *supra* note 192 at 280-82.

States can disregard uniform law proposals, and indeed tend to do so where uniformity is likely to have greater costs than benefits.[302] Thus, it might be argued that NCCUSL-type proposals can do little harm. Conversely, NCCUSL might do good if it leads to uniformity in a situation where it is efficient, as is arguably the case for sales transactions like those covered by UCITA.[303] Nevertheless, NCCUSL's influence may cause states to enact inefficient provisions that they would not otherwise adopt by cloaking interest group legislation in NCCUSL's officially accredited mantle, focusing attention on a particular proposal that helps spur widespread adoption, and lobbying state legislators.[304]

D. UNIFORMITY WITHOUT NCCUSL

If state law uniformity is desirable, there is good reason to suppose that the law will tend toward uniformity even in the absence of a formal uniform law proposal. First, many of uniformity's benefits can be gained without uniformity across state laws if firms or individuals contract to apply a single law to their transactions. This might be characterized as "vertical" uniformity, with firms piling onto a single law, as distinguished from "horizontal" uniformity across the states.

Second, just as lawmakers have incentives to adopt efficient laws in order to attract firms to their states,[305] they also have incentives to avoid non-standard laws that vendors and consumers will shun because the costs of diversity outweigh the benefits of adhering to a standard. Thus, state laws may spontaneously converge on an efficient standard without the benefit of NCCUSL or ALI proposals.[306]

Third, uniformity also might arise where an industry or lawyers' group is able to internalize the costs of providing a model law because the members receive collective benefits from improving the law or individual reputational benefits by participating in drafting. Although such a law might reflect the specific aims of interest groups, these groups have valuable expertise as well as an incentive to write balanced laws that states will adopt.

These types of spontaneous uniformity may be superior to uniformity arising from the NCCUSL process because the resulting standard does not share the defects of a NCCUSL proposal of interest group compromises and reliance on politician-generalists. Moreover, undirected uniformity may arise more quickly than NCCUSL-led uniformity because NCCUSL waits for the development of a consensus in order

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[302] *See generally* Ribstein & Kobayashi, *supra* note 288.

[303] *See id.* at 150.

[304] *See id.* at 146-48 (discussing NCCUSL's ability to cause the adoption of its proposals).

[305] *See supra* text accompanying notes 245-247.

[306] *See generally* Kobayashi & Ribstein, *supra* note 119.

to ensure widespread adoption. Indeed, interest group politics may lead NCCUSL to reject an existing consensus or standard even if this would further the uniformity objective. Thus, a model law has been shown to produce greater uniformity over a given time span than the equivalent uniform law.[307] Although uniform law drafters theoretically might seek to maximize uniformity by anticipating what states will do,[308] the interest groups that participate in the NCCUSL process might prefer proposals that favor their interests to those that would maximize uniformity.

The important question is whether potential problems with unguided uniformity might justify using the uniform law process. For example, the states might align with an inefficient standard because they engage in "herd" behavior that causes legislators to disregard their judgment.[309] The reasons for such behavior are not clear, and in any event there is data inconsistent with herding by state legislators.[310]

"Network externalities" also might cause the wrong standard to take hold or to persist. However, even if this theory is generally viable,[311] its implications for uniform laws dealing with electronic commerce are ambiguous. Although network externalities arguably might prevent a move to a more efficient standard without NCCUSL's help, network externalities also might lock in an inefficient NCCUSL standard.[312] In other words, the network externalities theory says nothing about the relative efficiency of officially promoted and spontaneously generated standards.[313]

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[307] *See* Ribstein & Kobayashi, *supra* note 292 (showing that, in the Uniform Limited Liability Company Act, NCCUSL failed to mimic widely adopted state laws although doing so would maximize the likelihood of uniformity).

[308] *See* Janger, *supra* note 286, at 591-92.

[309] For general discussions of herd behavior as applied to investments, see Abhijit V. Banerjee, *A Simple Model of Herd Behavior*, 107 Q.J. ECON. 797 (1992); Sushil Bikhchandani et al., *A Theory of Fads, Fashion, Custom, and Cultural Change as Informational Cascades*, 100 J. POL. ECON. 992, 1012-13 (1992); David Scharfstein & Jeremy C. Stein, *Herd Behavior and Investment*, 80 AM. ECON. REV. 465 (1990).

[310] *See* Kobayashi & Ribstein, *supra* note 119.

[311] *See supra* §IV(C)(2).

[312] *See* Garvin, *supra* note 294, at 349-50 (noting that if, through uniformity, "the law is frozen incorrectly, it may alter greatly the continued development of an important industry"). *See also* Michael Froomkin, *Article 2B as Legal Software for Electronic Contracting—Operating System or Trojan Horse?*, 13 BERKELEY TECH. L.J. 1023, 1031 (1998) (concluding that UCC 2B is technologically premature in its standards for electronic contracting).

[313] *Cf.* Liebowitz & Margolis, *supra* note 254 (arguing that network externalities does not demonstrate whether the QWERTY keyboard was superior to the Dvorak keyboard, or the VHS videotape format was inferior to Betamax).

An implication of this analysis is that state law uniformity may be efficient only to the extent that contractual choice of law is not fully enforced. If so, rather than forcing parties to accept a flawed uniform act produced by a centralized process, it would be preferable to allow them to choose the statute that best suits their needs.

VII. A FEDERAL/STATE COMPROMISE

This Part considers whether federal law might play a limited role as an adjunct to a state regime of contractual choice rather than as the source of substantive regulation. First, federal law might provide a shortcut around the evolutionary process discussed above by ensuring immediate enforcement of contractual choice of law and forum. Second, federal disclosure requirements might address information asymmetry problems inherent in contractual choice of law. However, this Part shows that, despite the theoretical benefits of this type of federal law, it might be better to leave regulation to the competitive state law process.

A. FEDERAL CONTRACTUAL CHOICE STATUTE

Congress might enact a statute mandating the enforcement of contractual choice of law, exercising its powers under the Commerce or the Full Faith and Credit clauses.[314] The statute might provide for application either generally or in Internet transactions where choice of law is a particular concern.

There would, however, be significant problems with a federal statutory approach.[315] Apart from the basic statute implementing the clause,[316] Congress has exercised its full faith and credit power only once in the last 200 years – to empower states *not* to enforce a state law, including one contractually selected in a contract, to the extent that it authorizes same sex marriage.[317] Enacting neutral procedural rules probably would not earn enough rents for federal legislators to justify the political risks of interfering with the traditionally state-governed area of conflict-of-laws.[318] This suggests that Congress is unlikely to pass a general choice-of-law statute. It may act specifically regarding Internet transactions, but then probably in response to the

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[314] U.S. CONST., Art I, § 8; Art. IV, §1. For a leading proposal favoring a federal choice-of-law statute, *see* Michael H. Gottesman, *Draining the Dismal Swamp: The Case for Federal Choice-of-law Statutes*, 80 GEO. L. J. 1 (1991).

[315] *See* O'Hara & Ribstein, *supra* note 151 at 1224-25.

[316] *See* 28 U.S.C. §1738.

[317] 28 U.S.C.A. § 1738c.

[318] *See* Macey, *supra* note 262.

pro-regulatory coalition that is likely to influence federal substantive regulation,[319] and therefore subject to significant exceptions. Indeed, the federal statute might serve only to lock into inefficient regulation that state competition ultimately would have eroded in the absence of federal law.

A better approach to federal regulation would be to mandate enforcement of choice-of-forum clauses. This would be consistent with federal cases favoring enforcement of choice-of-forum clauses and with the Federal Arbitration Act, which mandates enforcement of arbitration clauses in some situations.[320] This type of statute would not involve the same problems as a choice-of-law statute, since it would be neutral as to the type of law that is enforced. However, there remains the danger of exceptions to enforceability that inhibit evolution of efficient law.

B. DISCLOSURE REQUIREMENTS

Federal law might support enforcement of contractual choice of law and choice of forum clauses by providing for a uniform disclosure requirement. This would undercut criticism of such clauses based on information asymmetries.[321] Moreover, even if markets can address most such problems in the absence of regulation,[322] state regulation arguably exacerbates the problem by punishing firms under varying standards for making misleading disclosures or failing to adhere to stated policies. Thus, in the absence of mandatory standards, firms may be better off not saying anything. A federal standard could alleviate this problem.

VIII. IMPLICATIONS AND CONCLUSION

Electronic commerce is best regulated at the state rather than the federal level. It would be counterproductive to straightjacket emerging technologies and business practices with a federal law, at least before a process of state experimentation, competition and evolution has had an opportunity to discover the right approach or mix of approaches. At this point, there is not even a clear basic model for allocating rights in this area. A state law approach will not lead to over- or under-regulation as some have predicted as long as merchants and consumers can contract for the applicable law and forum. Indeed, this approach points the way toward solutions for other aspects of Internet regulation.

This article has implications for other aspects of Internet regulation. First, although this article has focused on situations in which there is a contractual interface between suppliers and the most directly affected parties, aspects of the

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[319] *See supra* subpart V(B).

[320] *See supra* subparts IV(A)(1)-(2).

[321] *See supra* subpart IV(A).

[322] *Id.*

analysis also apply as to conduct, such as child pornography and gambling, where regulation is arguably necessary to protect non-contracting parties. In such situations states may be justified in refusing to enforce contractual choice of law and forum where the conduct has caused harm within the jurisdiction. Thus, enforcing such contracts is not a viable solution to costly diversity and potential over-regulation by multiple state laws. However, firms still have the option of avoiding jurisdictional contacts with states that impose excessive regulation.[323] This may be enough to constrain the most egregious forms of state regulation. Moreover, it is important to keep in mind that any federal law will not necessarily be more reasonable, might be subject to bureaucratic agency creep, and may not preempt all existing state laws that might relate to the conduct.[324] Regulation of gambling is a cherished state prerogative, particularly in that state-run gambling provides a large source of state revenue. It is hard to believe that Congress would see enough political capital to incur the political costs of stepping on this prerogative.[325]

Second, this article has focused on U.S. regulation of electronic commerce. Regulation by other countries of websites accessible everywhere in the world obviously gives the subject a global dimension. As discussed above,[326] global firms might seek federal regulation in the U.S. in order to level the playing field with their non-global competitors. However, as a matter of general policy it would be better to give the state law approach a chance to take root and demonstrate its merits as compared to a one-size-fits-all federal or global standard. U.S. firms can use their considerable market clout to force non-U.S. regulators to abandon or moderate their protectionist approaches. Moreover, a choice of law model, having demonstrated its success in the U.S., could be scaled up to provide a model for global regulation. The alternative of US firms complying with European standard would be a global victory for mandatory privacy policies.[327] Thus, what may be good policy for some firms in the short run may be bad policy for electronic commerce regulation in the long run.

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[323] *See supra* §IV(B).

[324] *See supra* Part V.

[325] *See* Macey, *supra* note 262.

[326] *See supra* subpart V(B).

[327] See Reidenberg, *supra* note 9.

TABLE 1

EXAMPLES OF PROPOSED STATE LEGISLATION

	Notification	Affirmative consent
1999 AK H 273 (applies to ISPs.	By mail or e-mail at time of subscription.	Written opt-in.
1999 AK H 410 (applies to ISPs.	Same.	Written opt-out.
2000 AZ H 2717	At time of contract and annually for personal and sensitive information if used for marketing or if sold to third parties. No requirement if not used or sold, or for collection of marketing information.	Opt-out for personal information, separate written opt-in for sensitive information.
1999 CA AB 1793 (applies to ISPs	Requires knowledge of subscriber. Separate confirmation of consent required for each disclosure	Separate affirmative consent required for each disclosure.
2000 CO H 1459 (applies to websites)	Must disclose fact that information is being collected, and purpose for which information is being collected.	Consumer must have option to opt-out.
1999 KS H 2896 (applies to ISP)	Requires knowledge of subscriber.	Separate written opt-in.
1999 MA H 4483 (applies to Internet Computer Service)	Requires "informed" written consent.	Written opt-in.
1999 MI H 4171 (applies to ISP)	Requires notification of intention to collect and sell data.	Consumer can opt-out.
1999 MN H 3731 (develop privacy notice) (also 1999 MS S 1716, 1999 MN S 3588.	Required at time of agreement, must be clearly and conspicuously disclose nature, frequency and purpose of use, to whom information will be disclosed, and period of time information will be maintained.	Consent required.

2000 NJ A 591	Requires clear and conspicuous disclosure of identity of operator, nature of information collected, purpose of use, and with whom information will be shared.	Consent required.
1999 NY A 1909 (applies to online computer service)	Notice at time of agreement with clear and conspicuous disclosure of nature and use of information, length information will be kept, nature, frequency, and purpose of disclosure, including identification of types of persons information will be shared with.	Consent required.
1999 NY A 8130, 2000 NY S 5590 (develop model privacy notice)	Same as above, with additional disclosure about nature of steps being taken by entity to ensure the confidentiality, integrity and quality of data.	Requires express consent.
1999 NY A 9401, 2000 NY S 7754 (establishes voluntary privacy law)	Requires disclosure of the identity of any third party that will receive information, and for what purpose information will be used.	Requires affirmative written consent, which can be revoked at any time.
1999 NY S 8021	Information clearly described in clear and distinct form.	Executed by separate signature.
1999 OK H 1651 (applies to internet computer service)	Description of disclosure that will be made and subscribers' rights.	"Informed written consent."
1999 TN H 2302, 2664, 2000 TN S 2360, 2836. (applies to on-line computer service)	Notice at time of agreement of nature and use of information collected, nature, frequency and purpose of use, period information will be maintained, and description of procedures through which subscriber can obtain access.	Requires consent.
1999 WI S 375 (applies to websites)	Display of notice describing information collected.	Consumer must be allowed to opt-out.

TABLE 2

REGULATORY ALTERNATIVES

Nature of Regulated Data	• Sensitivity
	  o Sensitive (with clear expectation of privacy) vs. non-sensitive personal data.
	• Substitutability
	  o Idiosyncratic vs. fungible (valuable only when aggregated with data from others).
	• Identity
	  o Personally identifiable vs. anonymous.
	• How Collected
	  o Passive (clickstream/tracking) vs. active collection.

Disclosure Requirements	• Information to be Disclosed
	  o Fact of collection and potential use vs. specific detail, including nature and type of information collected, how information is to be used, identity of any third party that will receive the information.
	• How Disclosed
	  o On welcome screen, available on site, or available by request.

Consent Requirements	• Consent Trigger
	  o Collection vs. use by third-party or use related to collection
	• Type of Consent
	  o Negative (opt-out) vs. Affirmative (opt-in)
	• Manner of Consent
	  o Assent/clicking vs. in writing/electronic signature
	• Frequency of Disclosure/Consent
	  o At time of initial agreement or visit vs. each time disclosure of data occurs.

Exemptions to government regulation	• Industry self-regulation • Consumer self-protection (e.g., P3P)

Preemption of State Law	• Scope
	  o Broad preemption of state law vs. no preemption
	  o Exclusive federal enforcement vs. concurrent state and private enforcement.

State Regulation Of Electronic Commerce

- Preemption with Exceptions
  - Fraud & Consumer Protection
  - Tort, common Law, and other state or private civil actions.