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March 20, 2000

Mr. Donald S. Clark, Secretary
Federal Trade Commission
Room H-159
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Re: **Alternative Dispute Resolution for Consumer Transactions
in the Borderless Online Marketplace**

Dear Mr. Clark:

I am writing in response to the Initial Response Requesting Public Comment on the above topic that was issued by the FTC and the International Trade Administration of the Department of Commerce in February. I will ultimately focus on Question #15 under "Role of Governments." Because I have studied this issue strictly in the context of domestic trade and the authority of the FTC, I respectfully address my remarks to you. Whether an international consensus can be achieved on alternative dispute mechanisms for online transactions between citizens of different countries is beyond the scope of this comment. As information, I am a student of law at Georgia State University with an interest in alternative dispute resolution, and I have been an avid online consumer since 1998.

Basic Rulemaking Authority and Obligations of the FTC

Over two hundred years ago the framers of the Constitution granted Congress the power to make the laws of the land, including the power "To regulate commerce."¹ The President and Chief Executive was charged with "tak[ing] Care that the Laws be faithfully executed."² And an agency of the Executive Branch, the Federal Trade Commission, has had some of the responsibility for regulating commerce ever since the agency was formed in 1914 by Congress to prevent "unfair methods of competition...and unfair or deceptive acts or practices in or affecting commerce."³

The FTC is not the exclusive administrative agency working in the commerce arena, nor has it enjoyed unfettered rulemaking privileges. As recently as 1973, the agency fought (and, at the District Court level, lost) a challenge from a coalition of petroleum trade associations and gasoline refineries that it had no authority under its enabling act to make trade regulation rules at all.⁴ Though the D.C. Circuit observed, in reversing the court below, that "The Federal Trade Commission is a creation of Congress, not a creation of judges' contemporary notions of what is wise policy," the FTC is clearly subject to the "hard look" review of the judiciary.⁵ In fact, its enabling act now spells out the method by which any interested party, including an individual consumer, can request judicial review in one of the circuit Courts of Appeal whenever the FTC implements a new rule that establishes unfair trade practices.⁶ The FTC is subject to legislative scrutiny and modification as well. For example, in 1980 Congress, exercising "the power of the purse," kept the FTC from taking final action on a number of consumer protection rules until the legislators could enact new statutory controls on the FTC's authority.⁷

The FTC's enabling act is the Federal Trade Commission Act, and in that act Congress empowered the agency to make substantive rules of business conduct, rules that specifically define acts or practices which are unfair or deceptive and that affect commerce.⁸ A violation of one of these rules is considered a violation of Section 5(a)(1) of the Trade Commission Act⁹ unless the FTC has expressly provided otherwise.¹⁰ The Administrative Practice Act procedurally governs the agency.¹¹ Since the Trade Commission Act does not require that its rules be made "on the record after opportunity for an agency hearing," the FTC's rulemaking activities fall under APA § 553 - Rule making.¹² A proposed rule under the generic APA guidelines must generally be announced to the public in a notice in the *Federal Register* at least 30 days before it is enacted. The APA-mandated notice provides the time and place of the rulemaking proceedings, the legal authority under which the rule is proposed, a description of what the rule is about, and an opportunity for interested parties to submit written comments.¹³ The FTC additionally provides the text of the proposed rule, reveals any alternatives it is considering, relates its reason (described with particularity) for proposing the rule, and furnishes a preliminary regulatory analysis, with information to the public on how to get a copy of that analysis.¹⁴

Beyond Minimum Notice and Comment Requirements

The FTC's guidelines are more sweeping than that, for they also provide notice to the public when there is an "area of inquiry under consideration."¹⁵ Before drafting a rule, while just "thinking about" doing something, the FTC often solicits comments and meets with the public, as it is on the issue of ADR for online consumer transactions. These guidelines are anchored in the enabling act, which is procedurally more demanding than the APA.¹⁶ While the Trade Commission Act specifies that the FTC is not to proceed under §§ 556 and 557 of the APA when making its rules, it requires an "informal hearing" whenever proposed rules will define unfair trade practices.¹⁷ Features of the informal FTC hearing include oral presentations by interested persons and opportunities for cross-examination and rebuttal.¹⁸

Courts have held that when the public at large (as opposed to smaller, more identifiable groups) is affected by rulemaking, the mere opportunity to comment on a rule that is going into effect within 30 days satisfies the minimum requirements of due process. Because the FTC's rules can predictably affect industry-specific interests, the hybrid rulemaking process Congress has given it provides a useful safeguard against Constitutional challenges. Nevertheless, the agency, with its earlier and wider-ranging involvement of the public, appears to be a governmental body that supports fair dealing and democratic participation. FTC guidelines give it the freedom to depart from its usual procedures as it starts a rulemaking proceeding, but if it does, the agency announces the procedural changes in the *Federal Register*.¹⁹ It routinely uses notice and comment rulemaking rather than attempting to communicate most of its rules through individual adjudications, a process which traditionally yields fuzzy "rules" and unpredictable results, and costs participants time and money as minor variations on a theme are relitigated over and over.

The FTC has certainly not been without critics, however. One commentator has bemoaned its "deliberate pace," noting that the one to two years it took the FTC to go from notice of proposed rulemaking to final rule in the 1960s had stretched to an average of five and one-third years in the late 1970s.²⁰ This was after Congress had inserted hybrid rulemaking requirements into the Trade Commission Act. The informal rulemaking process at the FTC and other federal agencies had, by the 1990s, become so weighed down with additional procedures, analytical requirements, and external review steps that rulemaking was no longer clearly superior to case-by-case adjudication in the opinion of some observers.²¹ When the FTC asked for public comments on electronic

commerce issues in 1999, some respondents condemned its growing interest in commercial transactions on the Internet as an overreaching effort of “big government.”²²

The “Revolution in Internet Commerce”²³

Federal Trade Commission Chairman Robert Pitofsky recently discussed the possibilities and the significance of electronic commerce to consumers, highlighting the Internet’s advantage in offering a range and variety of products and a source of relevant information that surpasses anything ever seen before.²⁴ More than 120 million Americans have access to the Internet, and the total number of Internet users in other countries recently exceeded those in America.²⁵ E-commerce, long-touted but also long lagging behind e-mail as the Internet’s most popular use, has been rapidly increasing. The \$3 billion in sales that was transacted on the ‘Net in 1997 tripled to \$9 billion in 1998.²⁶ 1999 sales have been estimated at around \$15 billion.²⁷ By 2004, experts predict that \$184 billion will change hands in cyberspace.²⁸ Though most people are honest, when that much money is bandied about, opportunists appear.

The FTC’s efforts to protect consumers from Internet fraud in 1999 are summarized in the most recent Annual Review of Antitrust Law Developments²⁹. The agency dismantled numerous pyramid schemes. One such scheme was disguised as a legitimate multi-level marketing plan.³⁰ In another, individuals who thought they would earn \$13.50 an hour for processing applications at home received kits instead that showed them how to place Internet ads similar to the one they had answered so they could sell kits to those who responded to their ads.³¹ Other fraudulent online activity stopped by the FTC last year included deceptive claims of “miracle cures” for cancer and other serious illnesses,³² the marketing of HIV home detection test kits that produced erroneous results,³³ sales of unregistered stock that was pitched to capitalize on fears of the predicted Y2K bug,³⁴ and “cramming” small businesses by billing them for services that had been advertised as free.³⁵ The FTC halted more than 100 such incidents of online fraud and deception.³⁶ In seventeen of those cases, the use of unsolicited commercial e-mail or “spam” was integral to the operation of the scheme.³⁷

Interestingly, these pressing problems of e-commerce are hauntingly familiar. They resemble the scams that persist in the offline, “brick and mortar” world despite the continued best efforts of law enforcement. Small businesses, for example, have long been billed for items they were convinced were free after talking to a telephone salesman who was operating out of a temporary boiler room. For decades, shut-ins eagerly responding to “envelope stuffing job” ads in the back of the tabloids have been sent cheap kits of information and advised to place their own deceptive ads.

Walking and Pointing...to Pointing and Clicking

The shopper at the turn of the 20th century could not have imagined the millisecond “point and click” purchases that can be made by an online shopper at the turn of the 21st century. The earlier shopper likely walked to the local merchant’s establishment and pointed at items of interest displayed on a shelf behind the shopkeeper. Yet the basic character of the transaction is the same, and if one thinks about it, there were many transitional steps along the way that “primed” today’s consumer for online shopping.

- Local merchants gave way to national retailers and franchise operations, minimizing the importance to the consumer of really knowing who he was buying from.

- National retailers started offering merchandise that consumers purchased from a drawing in a catalog, eliminating the necessity of actually seeing an item before buying it.
- Women began entering the workforce in unprecedented numbers, leaving no one in the household who had time for leisurely shopping.
- Catalogs, once limited to two or three mass retailers, expanded to innumerable boutique operations and specialty stores that offered beautifully photographed merchandise that couldn't be found in one's hometown.
- Local retailers began sending flyers of featured merchandise to the home, encouraging customers to order by telephone or through the mail, with the local retailer mailing the merchandise to the home just as the out-of-town retailers did.
- Shopping mall development exploded, then standardized, so that a mall in one city became almost indistinguishable from a mall in another city, giving the consumer the sense of the national marketplace and minimizing the importance to the consumer of the specific location where a purchase is made.
- Credit cards proliferated; cash or check was no longer required to make even the smallest purchase, whether the seller was local or distant.
- Toll-free numbers became ubiquitous and consumers abandoned paper order forms and checks, finding it quicker and simpler to call a catalog operator and provide a credit card number to pay for their order.
- Fax-in options were made available, and consumers began recording their credit card information on order forms that were transmitted electronically to the merchant.
- Catalog ordering houses began running 24/7 operations, giving the consumer an expectation that shopping should be available at any time, day or night.
- Television shopping was introduced, combining the accessibility and convenience of the catalogs with live demonstrations of merchandise and a recurring cast of sales personalities.
- Slow and unreliable modems were replaced by better engineered, high speed modems and alternate Internet access options; the consumer's connection to the Internet became swifter and more reliable, and web pagers began loading quickly enough to make paging through an online catalog less frustrating.
- Online shopping sites began touting more sophisticated security for personal and credit card information, expanded their e-store offerings, provided better web site design and information, guaranteed the customer's satisfaction, and promised no-hassle returns.
- Trusted, established retailers established virtual storefronts on the web, enhancing the image of the online seller.
- Shopping bots enabled consumers to discover, within seconds, the web site where the item they wanted could be purchased for the lowest price online.
- Online banking, bill paying services, and credit card clearing services began to blossom, making electronic transactions on the 'Net even more convenient.

Offline and Online Consumer Transactions - Different Yet Comparable

Purchases made in the brick and mortar world and in the virtual world have a great deal in common:

- The merchandise is the same; almost anything that can be bought at the local mall can be bought online.
- Alternatives for the method of ordering are available; the online customer can, for example, almost always call in an order or print out an order form and mail or fax it with payment

information. Most in-person retailers will handle transactions over the telephone at the customer's request.

- Prices are comparable, with the low-overhead online merchant competing effectively with the in-person retailer's sales and clearance events.
- Warranties and return privileges are generally available to consumers who demand them and who buy from a competitor if the first merchant doesn't provide them.
- Consumer watchdogs exist in both worlds and maintain data that can be consulted before a shopper does business with a merchant (for example, the Better Business Bureau offline and BizRate.com online).
- Both offline and online retailers sell customer information to marketers of other products and services. Privacy concerns and the ability to avoid unsolicited mail, telephone calls, and e-mail are important to consumers in both environments.
- The basic business principles are immutable. Consumers patronize and award merchants who are courteous, responsive, honest, and price their merchandise competitively, while they stay away from and warn others about the merchants with whom they have had a bad experience.

Even in the areas where online shopping significantly departs from the traditional, in-store shopping experience, there is often a pre-existing and comparable offline shopping experience.

- Face-to-face contact between the business people and the consumers is limited or non-existent online (but the same is true of catalog purchases and purchases from television shopping networks.)
- Little capital need be invested in physical facilities, and the online merchant, sight unseen, may be operating out of a ramshackle and disreputable-looking location that may not adequately protect the merchandise being offered (but the same can be true of catalog retailers).
- Because of the relatively low start-up costs, an online merchant may be an inexperienced, undercapitalized, and underinsured business person whose operation may collapse before the merchandise is sent (this, too, can be true of catalog retailers, although with Internet start-up expenses being lower, the likelihood is probably greater online).
- If all contact is online, consumers may have no redress if their e-mails to the merchant are not answered (*caveat emptor*; consumers can easily learn not to do business on a web site that lacks full and credible identification and verifiable contact information, including telephone number and mailing address).
- Online customers can't actually look, taste, touch, smell, and so forth before buying unless they have seen the item in person elsewhere (but the same is true of both television shopping network purchases and catalog purchases).
- According to anecdotal data, the average amount of an Internet purchase is less than a traditional retail purchase.

An Overview of Alternative Dispute Resolution (ADR)

The earliest form of dispute resolution was violence. Litigation became the formal civil alternative. But there have been alternatives to litigation for all of recorded history, though the procedures may not have been standardized to the extent they are today, and the labels may have been different. The three major alternatives are negotiation, mediation, and arbitration, with mediation and binding arbitration being most closely identified with modern ADR. Compared to

litigation, the advantages and disadvantages these two ADR techniques in their classic forms can be roughly charted as follows:

	<u>Mediation</u>	<u>Arbitration</u>
Avoiding cost	+	+
Saving time	+	+
Saving emotional cost	+	+
Obtaining finality	-	+
Setting precedent, establishing a principle	-	-
Continuing relationship	+	+
Obtaining vindication	-	-
Obtaining peace	+	+
Obtaining money	-	-
Obtaining justice and fairness	+	+
Having some input on who the 3rd party is	+	+
Confidentiality and privacy	+	+
Having the law strictly applied	-	-

Between mediation and arbitration, the biggest distinctions deal with party flexibility and finality. For the process to be fruitful, both parties need to enter mediation with some openness toward compromise or a willingness to settle for less than their very best outcome. In arbitration, there will be a clear winner and a clear loser; there is usually no “splitting of the baby.” Mediation doesn’t have to result in a final resolution; traditional binding arbitration will end the dispute with little realistic opportunity for the arbitrator’s decision to be reviewed. Mediation is the less formal procedure of the two; arbitration is a quasi-judicial hearing, though not every courtroom procedure will be employed. The Federal Rules of Evidence, for example, may not be enforced during arbitration testimony.

While hybrids and variations have sprung up in the field of ADR, including mandatory negotiation, the mini-trial, the summary jury trial, and early neutral evaluation, mediation and arbitration continue to be the mainstays of ADR.

Role of ADR in Consumer Disputes

Arbitration of consumer disputes has become increasingly common. For example, in the summer of 1992, the Bank of America in California announced that all its contracts with depositors and credit-card holders would contain arbitration clauses.³⁸ Its disputes with individuals are decided by arbitration under the commercial rules of the American Arbitration Association, while class actions are referred to a neutral under California’s “rent-a-judge” statute.³⁹ Wells Fargo followed the Bank of America’s lead, with a mandatory “Comprehensive Dispute Resolution Program” for its depositors and credit card customers.⁴⁰

Arbitration clauses also show up in securities brokers’ agreements with individual investors who open margin or option accounts; home buyers’ warranty service agreements; even on the back of cereal boxes, buried in the fine print of sweepstakes rules.⁴¹ The experiences of the automobile manufacturers with ADR may be especially instructive in the context of electronic commerce. For example, Chrysler has an internal dispute resolution process in which the manufacturer and the consumer make written submissions. There are no oral hearings or appearances; a decision is rendered on the basis of the written documentation.⁴²

ADR for online consumer transactions is problematic if it is mandatory and if the completed procedure is a bar to litigation. If all online merchants uniformly adopt such ADR procedures, the result is a contract of adhesion. An adhesion contract is one which offers the consumer goods or services on essentially a “take it or leave it” basis, with no opportunity to bargain, and under conditions that keep the consumer from obtaining the desired goods or services unless he acquiesces.⁴³ The weaker party ends up with no choice as to the terms of the agreement.⁴⁴ Nevertheless, in the case of arbitration, long-standing judicial interpretations of public policy supporting the Federal Arbitration Act mean that both arbitration agreements and the arbitration decisions themselves invariably stand. One way to address this concern would be to limit mandatory ADR to consumer transactions that do not exceed a certain amount, so the consumer making a “once in a lifetime” purchase online does not have so much at stake.

If ADR for online transactions is not mandatory, the burden falls unacceptably on the merchant, often a small business owner with limited resources, to have a variety of responses ready for dispute resolution. The merchant could potentially be vulnerable not only to industry and consumer watchdog complaint procedures and to lawsuits, but also to mediation demands, arbitration, and other alternatives. This would not meet the need the FTC has identified to provide a streamlined and affordable means for online merchants to deal with consumer disputes.

Role of Our Government in Developing an ADR Agenda for Online Transactions

Question 15 of your notice asks, *What should be the role of governments, if any, in connection with the use and/or development of alternative dispute resolution programs for online consumer transactions?*

My conclusion is that our government’s role should be minimal. Certainly, the FTC should not promulgate a trade regulation rule that would require ADR procedures to be used whenever there are consumer disputes about online purchases. Nor is an industry guide⁴⁵ from the FTC mandated by this emerging issue. My belief is that the FTC can best contribute its expertise by serving as an arm’s length advisor to merchant groups and consumer groups who may be interested in jointly developing guidelines and “best practices” for ADR procedures in e-commerce. As technology and the legal landscape change, what is needed will change, too. The Internet may become a largely self-regulating community. Conversely, a compelling need for a particular type of government intervention may become obvious as more and more citizens go online to make purchases, and as unforeseen issues emerge. We just don’t have enough experience with e-commerce to know yet.

If the FTC is going to get deeply involved in crafting ADR for online transactions, why not do the same for the offline transactions of consumers? The case for a less formal dispute resolution procedure for small business owners could be made there as well and, as previously examined, the differences between online and offline transactions are not that vast. There has been no public outcry about the transactions between consumers and merchants online that compels a different treatment for online transactions. Letting private parties contract between themselves for alternates to the court system is a moderate and better reasoned response.

There are a combination of federal and state constitutional guarantees, federal and state regulations, federal and state statutes, and voluntary codes of business conduct that provide protection for consumers today. While these protections were conceived in an offline world, they should be able to serve the online world, too, as it currently functions. A modification of wording

may ultimately be required in some of our current laws. For now, an interpretation by an authoritative agency of how the existing statutes on commerce apply to commerce on the Internet should be adequate to guide us as we monitor, with more than a little fascination, an online world that develops, changes, and grows each day.

Thank you so much for giving me this opportunity to provide input.

Sincerely yours,

Rebecca Brannan

Rebecca Brannan

¹ U.S. Const. Art. I, § 8, cl. 3.

² *Id.*, Art. II, § 3.

³ 15 U.S.C.A. § 45(a)(2) (1999).

⁴ *National Petroleum Refiners Assoc. v. FTC*, 482 F.2d 672 (1973). The statutory definition of a rule is:
The whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency... 5 U.S.C.A. § 551(4) (1999).

⁵ *Id.* at 674.

⁶ 15 U.S.C.A. § 57(e) (1999).

⁷ *See* FTC Improvements Act of 1980, 94 Stat. 374 (1980), *amending* 15 U.S.C.A. § 41 *et. seq.*

⁸ 15 U.S.C.A. § 57(a)(1)(B) (1999).

⁹ 15 U.S.C.A. § 45(a)(1) (1999).

¹⁰ 16 C.F.R. § 1.8(a).

¹¹ 5 U.S.C.A. § 551 *et. seq.* (1999).

¹² 5 U.S.C.A. § 553 (1999).

¹³ *Id.*

¹⁴ 16 C.F.R. § 1.11 (1999).

¹⁵ 16 C.F.R. § 1.10 (1999).

¹⁶ *Consumer's Union of U.S., Inc. v. FTC*, 801 F.2d 417, 420 (1986).

¹⁷ 15 U.S.C.A. § 57(a) (1999).

¹⁸ 15 U.S.C.A. § 57(c) (1999).

¹⁹ 16 C.F.R. § 1.20 (1999).

²⁰ Thomas O. McGarity, "Some Thoughts on 'Deossifying' the Rulemaking Process," 41 DUKE L. J. 1385, 1388-89 (June 1992).

²¹ *Id.* at 1386.

²² *See comments online at* <<http://www.ftc.gov/bcp/rulemaking/elecmedia/index.htm>> (e.g., "The Internet is an electronic world without borders...where people will generally resent heavy-handed interference from government regulators.... Many people think, if government regulators were as smart as they think they are, they'd be running Internet businesses and not working for the government.")

²³ FTC News Release, "Revolution in Internet Commerce is 'Profoundly Pro-Consumer' Pitofsky Says," 2000 WL 148698 (F.T.C.)

²⁴ *Id.*

²⁵ Debra A. Valentine, General Counsel, FTC, *prepared remarks before* Santa Clara University, Feb. 11-12, 2000

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ ABA-AR1999ALD Ch. VII.C.

- ³⁰ *Id.* at 205.
- ³¹ *Id.* at 209.
- ³² *Id.* at 207.
- ³³ *Id.*
- ³⁴ *Id.* at 208.
- ³⁵ *Id.* at 206.
- ³⁶ *Id.*
- ³⁷ *Id.*
- ³⁸ John S. Murray *et. al.* PROCESSES OF DISPUTE RESOLUTION (1996) 543.
- ³⁹ *Id.*
- ⁴⁰ *Id.* at 544.
- ⁴¹ *Id.*
- ⁴² *Id.* at 545
- ⁴³ BLACK'S LAW DICTIONARY 6th ed. (1991) 25
- ⁴⁴ *Id.*
- ⁴⁵ 16 C.F.R. § 17 *et. seq.*