

Lessons from Alibaba.com: government's role in electronic contracting

Qin Hu

Xun Wu and

Clement K. Wang

The authors

Qin Hu is a Lawyer, Legal Counsel of China Merchants Sekou Industrial Zone Company Limited, Shenzhen, China.

Xun Wu is based at the Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania, USA.

Clement K. Wang is Associate Director (Research), NUS Enterprise Centre, National University of Singapore, Singapore.

Keywords

China, Electronic commerce, Contracts, Legal systems, Transaction costs

Abstract

Although electronic commerce (e-commerce) can be a source of competitive advantage, will e-commerce businesses in countries like China flourish when governments still take a "wait-and-see attitude" as to prompting, protecting, and regulating e-commerce? The paper employs transaction cost economics in analyzing the role of government in regulating electronic contracting. Due to the transaction costs arising from e-commerce, explicit contracts between parties are usually incomplete. The paper argues that these contracts should always be backed by implicit contracts, which are determined by default rules in various governments. Therefore, it behoves governments urgently to fill gaps in incomplete contracts in e-commerce in order to foster a predictable legal environment for e-businesses, minimize legal risks and transaction costs, and maximize economic and social benefits. The authors believe that governments must also act in concert with one another at the international level to create a favorable and consistent commercial environment.

Electronic access

The Emerald Research Register for this journal is available at

www.emeraldinsight.com/researchregister

The current issue and full text archive of this journal is available at

www.emeraldinsight.com/1463-6697.htm

info

Volume 6 · Number 5 · 2004 · pp. 298-307

© Emerald Group Publishing Limited · ISSN 1463-6697

DOI 10.1108/14636690410564807

Introduction

Story of Alibaba.com

The development of e-commerce has been nothing short of explosive in recent years. Many believe that its growth and impact will only become more prevailing in the future. The sale of goods by US firms over the Internet, for example, is predicted to reach \$1.3 trillion by 2003. By 2004, European enterprises are expected to have online sales of \$1.6 trillion[1]. Companies in China, with the largest population in the world, are also probing this new source of revenue. The China Internet Network Information Center (CNNIC) issued an Annual Report in Internet Development in January 2000 that estimates that there were 22.5 million Internet users in China at the end of 2000[2]. A recent nationwide survey showed that China had more than 1,100 consumer related e-commerce Web sites by the end of the first quarter in 2000 (*People's Daily*, 2000). Four Web companies, Sina.com, Sohu.com, China.com, and Netease.com have already been listed on the NASDAQ. However, the country's e-commerce market is still in its infancy. We will begin with the story of Alibaba.com

Among all the developing e-commerce businesses in China, Alibaba.com has received much attention, despite not yet being listed on the NASDAQ. Alibaba.com's two biggest investors are US investment bank Goldman Sachs and Japanese Internet investor Softbank, Softbank's chairman Masayoshi Son is on the Alibaba board along with Peter Sutherland, former director general of the World Trade Organization. In July 2000, this company was featured by *Forbes* as its cover story and selected as the only company on the *Forbes* "Best of the Web: B2B" list founded in China (Doebele, 2000). Alibaba.com was selected again by *Forbes* as "Best of the Web: B2B" in September 2001. The company's CEO, Jack Ma, was selected as one of the 100 Global Leaders for Tomorrow by the World Economic Forum, and was honored as a recipient of the Asian Business Association Business Leadership Award in 2001. On 27 December 2001, with the join of the 1,000,000th Alibaba member, it became the only B2B Webster with 1,000,000 registered business members from 202 countries.

To date, Alibaba.com is the world's largest online business-to-business (B2B) marketplace for global trade and plays host to China's leading domestic B2B trade communities. With headquarters in Hong Kong and operations in Mainland China, it is struggling to become the number one destination for buyers and sellers from small and medium-sized enterprises (SMEs) to find trade opportunities, promote their businesses



and conduct transactions online. However, Alibaba.com has yet been at a high level of e-commerce. For online transaction, there are basically six levels as defined by Alibaba.com's CTO, John Wu: information exchange, negotiation, price bargaining, shipping, insurance, inspection and customs processing, and payment (Zhang, 2000a). It is at the lowest level that Alibaba.com is now operating. In other words, it only provides an information platform on which buyers and sellers meet each other and post business information. No transactions can be executed through the Web site. In other words, Alibaba.com only provides information services and online advertising to help the buyers and the sellers meet each other. Actual deals are struck offline or via e-mail. Alibaba.com derives its revenue only from online advertising, and had been operating in the red before 2001. Only when reaching the levels of price bargaining, shipping, insurance, inspection and customs processing will Alibaba.com justify itself in charging a fee and making a profit (see Zhang, 2000a). That is why Alibaba.com is strategically striving for higher levels of online business transaction, and exploring add-on features, including shipping, trade financing, online inspections, quality control services and insurance, etc. In December 2000, Alibaba.com signed separate revenue-sharing agreements with four leading global logistics providers to create an online quotation and e-contract platform for shipping and airfreight service, which will be hosted on the Alibaba.com marketplace and accessed by Alibaba.com's members[3]. It reported its first profit on a cash-flow basis in December 2001. It is expected to show a net profit for 2002 and likely be the most profitable of all the Asian dotcoms.

Has Alibaba.com been prepared for the risks arising from its new strategy of value-added services while it is striving to create more profitable opportunities at levels that go beyond information exchange? Will e-commerce businesses in countries like China to advance alone when governments still take a wait-and-see attitude as to prompting, protecting, and regulating e-commerce? What role governments will play in e-commerce? These questions are vital for e-businesses in China and other countries in the world. We try to illustrate these issues with the example of Alibaba.com by using transaction cost economic analysis of law.

Transaction cost economic analysis of law

Transaction cost economic analysis of law was developed by Coase (1937) and Williamson (1981) based on the traditional Chicago School analysis of law, which perceives the correction of market failure as the task of law. The factors for

market failure include monopolies, asymmetric information, externalities and public goods (Pindyck and Rubinfeld, 1998). That is to say, market failures exist when there are no multiple players on both side of the market (the problem of monopoly), when these players do not have symmetric and full information relevant to their market activities, when any of the players bypass the market through involuntary actions (the problem of externalities), or when the traded commodities is a public good. Central intervention within the market is justified only when there is a market failure (Elkin-Koren and Salzberger, 1999). The transaction cost economic analysis of law as an extension of the Chicago School analysis of law regards the transaction cost as another market failure (Coase, 1960; Calabresi and Melamed, 1972). Transaction costs result from the human nature characterized by bounded rationality, opportunism and transactions with crucial dimensions of uncertainty, frequency and asset specificity (Williamson, 1981). Therefore, it views a significant increase (decrease) in the role and justification for central regulation (which is usually justified as laws and regulations established by governments), when transaction costs are higher (lower).

E-commerce is an electronic technology-based way of doing business characterized by a borderless and uncertain nature. While decreasing the traditional costs through business cycle improvements, inventory reduction, improved productivity, quality and customer service, result in competitive advantages (OECD, 1999), e-commerce brings new market failures generally associated with technology, which include new types of monopoly, asymmetric information, externalities, public goods, and new transaction costs (Elkin-Koren and Salzberger, 1999). These new problems and costs make it necessary for governments to make laws to correct the failures and minimize the costs.

Electronic contracting

Explicit contract and implicit contract

Suppose Alibaba.com successfully provides the add-on services for the whole process of e-commerce from advertising, contracting, and delivering to payment, then, information flow, documentation flow and transaction flow must all be executed in its Web site. Fundamentally, numerous contracts for varied purposes have to be established, enforced, and will possibly be disputed. What will be the basis for the formation and enforcement of contracts as well as dispute settlement? Alibaba.com's Web properties have

already over 1,000,000 registered members from over 200 countries. Obviously at least over 200 countries' legal rules will play their roles explicitly or implicitly when Alibaba.com is developing their online businesses. This situation is confusing, and, more critically, is rather risky. In China, other than several regulations about Internet security and online advertisements and news, no rules and regulations have been advocated for the benefit of conducting e-commerce. E-commerce is being, and will be, conducted under numerous legal contingencies in a long period of time. As a result, transaction costs of e-commerce will be unpredictably high (UltraChina.com, 2000).

With regard to the enforcement of e-contract, under the circumstances of legal uncertainty, online businesses usually turn to click-wrap agreements or other similar forms of clauses for help. It seems there is an explicit binding contract between e-commerce participants, and the transaction will be safely governed by relative clauses in the contract, such as the clause of jurisdiction and applicable law. Nevertheless, whether such an explicit contract is binding and the transaction is safe ultimately depends on an implicit contract, which requires two factors. First, what the parties have agreed in the explicit contract be effective and enforceable under respective domestic legal system. Second, what the parties have not agreed in the explicit contract be governed by default rules. From the broad legal point of view, the Internet is not that different from the non-virtual world. Contracts will still be indispensable, rules have to be respected, and rights and duties of parties have to be identified and enforced. Therefore, in e-commerce settings, the terms and conditions of the explicit contracts are similar to those in traditional transactions. The explicit contract between parties will still include the following main articles:

- name of good or service;
- quality;
- quantity;
- delivery;
- payment; and
- selected ways of dispute settlement.

What matters is that the contents in the implicit contracts have to be changed when the conduit through which transactions are processed has evolved from paper (including facsimile) to the Internet. The implicit contract between e-contracting parties should include:

- Governmental recognition and acceptance of electronic contracts.
- General rules for the formation and performance of electronic contracts, for example, the location and identification of parties, the time and place of dispatch and

receipt of electronic messages for the purpose of determining the validity of electronic contracts.

- Globally-accepted standards for the system security in terms of authentication, authorization, confidentiality, integrity, and non-repudiation of origin (Stallings, 1995) to ensure the formation and legal validity of electronic contracts.
- General rules for determination of jurisdiction and applicable law for adequate redress mechanisms.
- General rules for clarification of responsibilities among e-commerce participants, including consumers, e-commerce merchants, Internet service providers (ISPs), software developers, and intermediaries such as certification authorities, and electronic payment providers (Chissick and Kelman, 1999).

Contracts form the basis of almost all the commercial transactions, including electronic transactions. When these contents of implicit contract are not settled, there exists no basis for the validity and enforcement of electronic contracts, and thus no basis for e-commerce.

Incomplete contract

It is a general rule and practice that a contract violating domestic law will be denied its effectiveness in that country. Simultaneously and more complicatedly, the economic model of perfect contracts is never realized under real world conditions. The contractual incompleteness has been primarily attributed to the transaction costs of contracting due to bounded rationality, which includes legal fees, negotiation costs, drafting and printing costs, the cost of researching the effects and probability of a contingency, and the costs to the parties and the courts of verifying whether a contingency occurred (Williamson, 1985). When the transaction costs of explicit contracting for a given contingency are greater than the benefits, the parties may prefer to leave the contract incomplete. Another source of contractual incompleteness is opportunism, i.e. strategic behavior by relatively informed parties, who might strategically withhold information in order to take advantage of relatively uninformed parties, and to increase their private gains from contracting (Ayres and Gertner, 1989). In e-commerce, for instance, a buyer might purposely conceal its place of residence and the fact that its jurisdiction denies the legal effect of e-contract. Thus, the seller will totally bear the risk of contract invalidity.

Therefore, the risk of contract invalidity and unenforceability has been aroused by the fact that e-commerce based on e-contract is significantly

different from traditional transactions based on written documents.

In the real world, it is impracticable for e-businesses to review the laws of individual countries when transacting online with numerous unknown participants from hundreds of countries. What they can do is to make an incomplete contract, leaving many contingencies to be clarified and governed by the implicit contract.

The economic and technological development makes electronic contracting prevailing in millions of transactions. However, no e-business alone has the right and capability to determine the content of the implicit contract. Here, governments can step in to play its irreplaceable role in making laws react to the felt need of commercial society: First, the electronic technology supporting e-commerce should be incorporated in paper-based contract law. Second, gaps in incomplete contracts should be filled when unexpected contingencies occur. The gap-filling provisions are called default rules. They govern when the parties did not specify their duties for specific future contingencies or those specified duties are not tailored to economically relevant future events (Ayres and Gertner, 1989). When so many transactions take place across the national boundaries in e-commerce, the transaction costs and the probability of strategic behavior increase, as a result, the parties are more ready to accept default rules. It becomes governments' urgent task to make their laws react to these needs since the fundamentality of contract law is to place the force of law behind the agreements made by the parties.

Government's role in electronic contracting

A country's readiness for e-commerce depends fundamentally on network infrastructure, including narrow and broadband, and on costs of Internet access. However, legal norms and standards (covering contract enforcement, consumer protection, liability assignment, privacy protection, intellectual property rights and process) and technical standards (regarding the way of online payments and product delivery, security, authentication, digital signatures, and connectivity protocols) are also significant policy considerations that must be taken into account by governments for creating an environment conducive to e-commerce (Goldstein and O'Connor, 2000).

Formation and enforcement of e-contracts call for legalization of various supporting systems, including the liberalization of telecommunication services, the establishment of a comprehensive,

uniform legal framework providing adequate protection of security, privacy and intellectual property right, the creation of efficient electronic payment system, and the creation of a competitive environment to improve services and reduce access cost, which are also required for the significant growth of e-commerce (UNCTAD, 2002).

Nations have endorsed different approaches to foster electronic transactions and will develop different rules to regulate these issues. This trend results in conflict of laws, which can only be eliminated by widely accepted standards. Governments have already taken various measures for this purpose at both national and international level.

Considering the indispensability of underlying implicit contracts between e-contracting parties, there are two fundamental tasks for governments.

The first task is to grant legal recognition to the new way of contracting – electronic contracting – in order to react to the development of electronic technology and electronic transactions. In the tradition of both the common law and the civil law, existing law does not impose specific requirements relating to contract form that contemplate the use of electronic messages. Therefore the legal validity of electronic messages and electronic signatures should be recognized by domestic law before e-commerce can stand firmly as a new way of doing business.

International and national legislation practice at present, for example, the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Electronic Commerce 1996, attempts to stay away from interfering with national law applicable to the contract formation, and adopts an assimilation approach that simply recognizes the legitimacy of electronic forms of contracts.

The UNCITRAL Model Law on Electronic Commerce 1996 has recognized the legal validity of electronic messages and electronic contracts in Article 5, 11, and 12[4]. This position has been supported and implemented in the proposed Article 2B of the US Uniform Commercial Code (UCC), the Singapore Electronic Transactions Act 1998, the Australia Electronic Transactions Act 1999, the UK draft Electronic Communications Bill 1999, and the European Union Electronic Commerce Proposal 2000. The validity of electronic contract depends on global acceptance.

After granting the legal recognition to e-contract, the second task of governments is to set globally accepted default rules for incomplete contracts to solve, for example, the problems of jurisdiction and applicable law contracts. The frequency and globalization of e-commerce make

it expensive, sometimes impossible to locate and identify the transacting parties, and thus leave it uncertain whose jurisdiction and law will prevail. With default rules in position, parties are able to contract around these rules, or resort to them when transacting without prior contract.

The common law system usually encourages parties to stipulate express jurisdiction and choice of law clauses in contracts and allows the clauses to override all other determinations of jurisdiction and applicable law. In case of no such clauses, for transnational transactions, the principle of private international law will be used to determine the jurisdiction and applicable law. The relevant elements include the dependent's domicile, expected place of performance, place of contract creation or contract breach, etc. The ultimate outcome is based on the specific situation and relevant legal system. In principle, the jurisdiction should be determined by minimum contacts founded upon business activities or tortious acts, and the determination of applicable law should be a matter of fact based on which law has the closest connection with the transaction.

Regarding the borderless nature and electronic technology-based characteristics of e-commerce as compared to traditional commerce, the traditional legal basis for relevant elements is no longer certain and clear. For example, when a company maintains a Web site that can be accessed from foreign countries, does the maintenance constitute a minimum contact sufficient for those foreign countries to confer jurisdiction upon that company? Courts may rely on such factors as the number of hits on the Web site from the forum to determine whether the contact with the forum was sufficient, just as the US courts did in several cases[5-7]. Following a case in 1997[8], the US courts generally divide the Web sites into three categories:

- (1) companies "doing business" online;
- (2) mere "passive Web sites"; and
- (3) the catch-all category (where there are some interactive capabilities but not active commerce).

A company running the first type of Web site will be subject to personal jurisdiction in all states where it does business. A company running the second type of site usually will not, and courts will conduct a fact-based inquiry for the third category. However, what will be the factors determining whether a Web site is active or passive? Certain activities such as e-mail and file downloads may be considered active while activities such as information display may be considered passive. Passive activities alone should not be considered a basis to support minimum contacts and thus warrant no claim on jurisdiction[9].

Regarding the choice of law in e-commerce, the National Conference of Commissioners on Uniform State Laws has drafted a new article in the Uniform Commercial Code (UCC) (Article 2B) to address applicable laws:

(b) In the absence of an enforceable choice-of-law term, the following rules apply: An access contract or a contract providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor is located when the agreement is made.

(1) A consumer transaction that requires delivery of a copy on a physical medium to the consumer is governed by the law of the jurisdiction in which the copy is delivered or, in the event of nondelivery; the jurisdiction in which delivery was agreed to have occurred.

(2) In all other cases, the contract is governed by the law of the jurisdiction with the most significant relationship to the transaction[10].

These provisions provide for a clear and unambiguous answer to the question of applicable laws, though it remains to be seen whether Article 2B will ultimately be effective.

In the European Union (EU), with regard to the problem of jurisdiction, there are two important documents: the *Convention on Jurisdiction and the Enforcement of Judgement in Civil and Commercial Matters* (ECC, 1988) and the proposed *Council Regulation on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters* (ECC, 2000). According to the relevant articles in the two documents, the jurisdiction of an electronic contract will be determined by the consumer's domicile in most cases.

With regard to the problem of applicable law, the EU (1980) *EC Convention on the Law Applicable to Contractual Obligations (Rome Convention 1980)* remains consistent with the common law positions. It provides in Article 3(1) that "a contract shall be governed by the law chosen by the parties". In the absence of this choice, "the contract shall be governed by the law of the country with which it is most closely connected."

Obviously, the uncertainty and the ambiguity of factors in e-commerce give countries more discretion in exercising their power over transactions. In Germany, the parliament passed a sweeping law on July 22, 1997, the *Information Communications Services Act*, subjecting any Web sites accessible from Germany to German law. No sign has showed that other countries will follow the practice of Germany when they stay silent toward this problem. There is no basis for anticipating e-businesses' exposure to unfavorable jurisdiction and law until governments state their position in their legislation and judicial practices.

The potential exposure to foreign jurisdiction and laws might deter businesses from conducting e-commerce. The harmonization between the

principle of consumer's domicile jurisdiction and that of supplier's home-country control becomes pertinent and relies largely on the work of international organizations. The Hague Conference on Private International Law is making an effort to establish a global convention on civil jurisdiction and judgments. A *Preliminary Draft Convention on Jurisdiction and the Effects of Judgements in Civil and Commercial Matters* was adopted by the Special Committee on June 18, 1999[11].

With the need for international cooperation in regulating e-commerce, efforts have been undertaken governments through leading international organizations including Organization for Economic Cooperation and Development (OECD), World Trade Organization (WTO), UNCITRAL, World Intellectual Property Organization (WIPO), Asia-Pacific Economic Cooperation Forum (APEC) and Free Trade Area of the Americas (FTAA)[12].

The OECD has promulgated a number of guidelines and policy reports aimed at examining the implications of e-commerce for governments, business, and the general public and at providing recommendations for further actions. The WTO General Council established a formal work program in 1998 to address e-commerce issues such as intellectual property, government procurement, import duties on information technology products, and services. The UNCITRAL has formulated a Model Law on Electronic Commerce in 1996 that supports the commercial use of international contracts in e-commerce. This model law establishes rules and norms that validate and recognize contracts formed through electronic means, sets default rules for contract formation and governance of electronic contract commerce, defines the characteristics of a valid electronic writing and an original document, provides for the acceptability of electronic signatures for legal and commercial purposes, and supports the admission of computer evidence in courts and arbitration proceedings. The Model Law is being implemented in many countries and is generally regarded as a useful reference by legislators throughout the world. UNCITRAL also was responsible for a Model Law on International Credit Transfers in 1992, and it published a legal guide on electronic funds transfers in 1987. WIPO member states approved the Digital Agenda in September 1999. The 11th APEC ministerial meeting in 1999 issued a statement noting the potential for electronic commerce to provide "extraordinary stimulus to regional growth and trade." The statement provides guidelines and measures for further work, with the aim of achieving paperless trading by

2005 for developed economies and by 2010 for developing economies. A joint government-private sector committee of experts, meeting under FTAA auspices, issued recommendations to ministers in 1999 calling for enhanced telecommunications infrastructure development, lower telecommunication costs, increased skills training related to digital technologies, and effective intellectual property protection.

The necessity of the above-mentioned two tasks for governments has already been illustrated by the UNCITRAL Model Law on Electronic Commerce 1996, and its wide acceptance by the USA, EU, Australia, Singapore, and other countries. Just as George Yong-Boon Yeo, Minister for Information and Arts and Second Minister for Trade and Industry in Singapore, pointed out in the ICC Conference in Paris in November 1997 (The World Business Agenda for Electronic Commerce) "We need sanctions against those who break the rules. Without legal jurisdiction in cyberspace, electronic commerce will be a marginal activity. It cannot flourish without law and order" (ICC, 1997). Ultimately, the task for governments is to reach a global consensus on the regulation of e-commerce. Then, the inconsistency of contract law of countries will be eliminated to the utmost for borderless e-commerce and seamless electronic marketplace.

Compared with e-businesses in developed countries, those in China like Alibaba.com are facing unlimited risks in a highly uncertain legal environment.

The first comprehensive and special investigation on the application of Internet and development of e-commerce level in Chinese enterprises was organized and conducted by State Economic and Trade Committee State in 2001, and a report titled *Report on the Investigation of Enterprises' Internet Application and E-commerce Development in China* was released on 19 December (State Economic and Trade Committee State, 2001). The report listed the crucial nine elements impeding the development of e-commerce in China in order of importance:

- (1) lack of network security;
- (2) insufficient telecommunication infrastructure;
- (3) lack of trust;
- (4) lack of law and regulations involving e-commerce;
- (5) problem of standardization;
- (6) problem of network payment;
- (7) lack of awareness of the benefits of e-commerce;
- (8) problem of Internet market scale; and
- (9) lack of human resource capacity-building on information technology and management.

With all these unclear elements of relevance to implicit contracts applying to electronic transactions, e-businesses in China are faced with limited legal risks and resulting potential costs when they only maintain “passive” Web sites providing online information flow service, i.e. staying at the first level of e-commerce. Once they decide to push their business forward to a deeper level of e-commerce, just as Alibaba.com is trying, a serious problem arises. This is what can be used to ensure the effectiveness and enforceability of electronic contracts between various participants, especially when part of such contracts needs to be executed in China while “China’s current system of laws and regulations does not create a particularly hospitable environment for the development of e-commerce” (Mckenzie, 2000). E-commerce cannot be conducted without sufficient supporting legal systems in the society.

The Contract Law of the People’s Republic of China, which came into effect on October 1, 1999, allows for electronic contracting for the first time in China. Article 10 of the Contract Law permits contracts to be made in written or other form, and Article 11 specifically defines “written form” to include electronic data text, including electronic data interchange and e-mail, that can tangibly represent the content of the contract. Article 16 also specifically provides that, where a contract is concluded through the exchange of electronically transmitted documents, a contract offer is effective when it reaches the offeree’s system.

Nonetheless, the legal environment for e-contracting is still unclear though the Contract Law 1999 recognizes the legal validity of electronic contract.

First, e-commerce is not being regulated in an integrated and uniform manner in China. In accordance with the Contract Law 1999, the legal validity of electronic contract is recognized. However, other laws and regulations may still require the traditional paper contracts. For instance, in order to get permission for paying and receiving foreign currency in cross-border transactions, Chinese businesses have to comply with reporting requirements for foreign currency exchange, and submit relevant contract between parties as supporting document. The current reporting regime assumes the existence of paper contracts, and does not recognize contracts in electronic format.

Second, the other elements that are imperative in the implicit contract between e-contracting parties have yet to be regulated. Especially, there is neither reliable security system nor nationwide credit card system to ensure the formation and enforcement of electronic contract. Over one-third of respondents to the Ministry of Information

Industry survey reported that security was their biggest concern in conducting business online. Companies also worry about protecting their electronic business systems from hackers. The availability of reliable encryption technology is eagerly required for protecting e-contracting parties from cyber-trespassing, hacking and other unauthorized harmful acts by unauthorized parties. However, the Administration of Commercial Encryption Regulations[13], which was issued and came into force on October 7, 1999, prohibit the sale or use in China of foreign-manufactured encryption products (Article 13, 14). The regulations also require foreign organizations and individuals using encryption technology of any kind to register the use with the State Encryption Administrative Commission (SEAC) (Article 15). Under this law, the security of e-commerce can only be expected until China-manufactured encryption technology is highly reliable.

The 2001 Report concludes that e-contracting and online performance of e-contracts are impossible at present stage at least due to the lack of network security, electronic payment, trust, and necessary law and regulations. Therefore, e-commerce for businesses is limited to distribution, collection, and communication of information online. Contract formation, payment, and delivery have to be conducted offline.

This is truly the case for Alibaba.com in selecting its business model and strategy. It concentrates its business on B2B because it is not optimistic about the future of B2C in China due to the barriers in payment method, transportation, and credit system (Zhang, 2000d). It also thinks it impractical to conduct transaction online at this period of time in China. Since its members reached 1 million on March 10, 2002, Alibaba has been increasing its revenues by two new ways apart from by online advertising. It launched “TrustPass”, which requires every new member joining Chinese site after March 10 has to undergo through a credit check. The annual fee for such service is US\$250. It also began to collect commission from its members. Hence, it continues to concentrate on developing its information platform though it still have the new value-added services in its mind, and is paving the way for new revenues. This strategy has already been confirmed by Jack Ma when he answered questions to the reporter from *South City Post* on 30 July 2001 [14].

To date, it is obvious that Alibaba.com has not been ready for e-commerce while Chinese government is surely not. It has been illustrated by Alibaba.com’s recent domain name dispute.

In this case, CNNIC’s reservation policy is adopted by government, but breaks the universally

accepted basic policy of “first come, first served” used in allocation of domain names. The court rules out the legality of the reservation policy but supported the legality of Alibaba’s ownership to its domain name in Chinese based on the same policy. What can be expected by e-businesses in such a confusing legal environment?

For e-businesses in China with so much market imperfections and high transaction costs, Alibaba’s story implies a survival and perhaps a successful strategy: educating the government and changing the perceptions of government officials while abiding by the government’s regulations on the one hand (Zhang, 2000b), probing the higher level of e-commerce cautiously while concentrating on low-level of e-commerce. A long-term plan is least desirable for an e-business due to the ever-changing situation. A walk-and-see attitude is most favorable for catching more opportunities (Zhang, 2000c).

While e-businesses in China manage to survive and develop by employing a conservative business strategy, it is the time for Chinese government to step actively in the development of e-commerce. In fact, strategy of developing e-commerce in China is essentially a government-driven one (*China Youth Daily*, 2001). It launched the Golden Project, which includes the Golden Bridge, an electronic information network linking provincial regional nodes with a central hub in Beijing; the Golden Card, an electronic money project designed to accelerate the development of electronic banking and a credit card system; and the Golden Gate, a foreign trade information network designed to promote information exchange concerning foreign trade and foreign investment, paving the way for eventual transition toward paperless trade. It is a top-down strategy with government banking and under government control such that it has been criticized as an attempt to strengthen government control, which may prevent businesses and individuals from fully exploiting the potential of the Internet (*China Youth Daily*, 2001). Let us look outside of China where Alibaba.com operates in the Asia Pacific Region. In this region, the level of development of technology and legal framework for e-commerce is unbalanced among countries and areas. Singapore, Hong Kong, South Korea, and Australia are equipped with a reliable telecommunications structure while others are not. Singapore, Hong Kong, and Australia have specific legal framework for e-commerce while others have none. When Singapore has taken positive steps in an attempt to encourage e-commerce by establishing relatively clear legal environment and tax incentives, others are taking a more conservative approach.

Owing to the diversities, this region lags behind North America and Europe in the adoption and regulation of e-commerce. From global perspectives, the proper infrastructure and integration must be first satisfied for the Internet to become a viable and successful place to do business. The success of e-commerce relies on the elimination of various national and regional diversities, among which the important one, if not the most important, is legal diversity. Partly for this purpose, the USA has proposed a global “hands-off” policy toward regulation of e-commerce (GIIC, 1999).

However, the “hands-off” policy is of little help to mitigate many problems for developing countries already affected by economic globalization. Hence, it is unwelcome by developing countries and some developed ones, including APEC countries. To contend with the US policy, APEC has been taking a measured approach, initiating the process of regionalization since the gathering of the APEC leaders from 21 economies in Vancouver in November 1997. For example, the APEC Telecommunications Working Group has worked on the liberalization and fostered the development of the telecommunications and information sectors, which represents both the basic foundation and the substance of e-commerce. As a result, on the way to the globalization, regionalization seems more likely to step in as the first stage of e-commerce regulation. Obviously, there is a long way to go for the regulation of e-commerce, starting from the diverse standpoint held by individual countries to regional consensus and ultimately to a global consensus.

Conclusions and implications

Law and economies are always interacting. Fundamentally, economic and social development affects the lawmaking process, and effective law leads to economic efficiency and social justice. When law plays an important role in creating a predictable environment for e-commerce, its ultimate task is to eliminate factors of economic inefficacy (market failures), and to create a perfectly competitive environment for electronic businesses to minimize legal risks and transaction costs and to maximize the economic and social benefits. A modern market economy requires laws that are constantly able to redefine rights and market relationships when new forms of corporate structure emerge, to provide ever-changing determinations of contractual obligations, and to redefine and enforce the rights of victims of new technologies and activities.

Nonetheless, law usually lags behind economic and technological development. In today's e-commerce, the reality is that technology is developing at a rapid pace and laws soon become outdated. Therefore, e-commerce provides businesses with greater possibility of both profit making and risk bearing. As a result, governments and e-businesses are obliged to prepare for using this double-edged sword.

For developing countries such as China that want to take share of revenues from e-commerce and catch up with developed countries in the new economy, it is essential for governments to accelerate their policy-making process and establish a predictable and consistent legal environment supporting e-commerce regardless of the jurisdiction in which particular transaction parties reside. On the one hand, governments should update their law to adapt to the development of electronic technology and e-commerce. Many countries, such as the USA, members of the EU, Canada, Australia, and Singapore, etc., have already made their attempt to regulate and prompt e-commerce by adjusting their legal systems (Baecelo, 1999). On the other hand, they must act in concert with each other at the international level to create a favorable and consistent commercial environment. At present, much work is being done by intergovernmental organizations, as illustrated by the efforts by OECD (1997) and WTO (1998) and the outcome they have achieved.

For e-businesses such as Alibaba.com, it is imperative that they pay attention to new legal issues emerging from e-commerce and examine their business strategies carefully. In addition to the explicit costs of hardware and software maintenance, technical support, facilities, education and communication line costs, it may be more important to consider and prepare for the implicit costs derived from legal risks and uncertainties, and to adjust and adopt appropriate business strategies accordingly. Making business decisions without considering relevant policy and legal environment is very dangerous. For making a good business decision, both benefits and costs must be taken into account and a careful cost justification analysis is essential (Hoskins and Lupiano, 1997). Neither should e-businesses ignore the legal risks while engaging in e-commerce nor wait for old laws to adapt to the new marketplace or for new ones to develop or be enacted. Instead, active examination of legal issues in e-commerce and cooperation with governments in creating a clear legal environment will help them stay abreast of the risks involved and the developing law, thereby doing business profitably instead of ending up in litigation and bankruptcy.

Notes

- 1 Based on estimates made by the Center for Research in Electronic Commerce, University of Texas, Austin and Forrester Research.
- 2 See www.cnnic.net.cn/develst/cnnic200101.shtml
- 3 Alibaba Press Release, available at: www.alibaba.com
- 4 UN Resolution No. 51/162 December 16, 1996
- 5 *Compuserve, Inc. v. Patterson* (1996), 89F 3d 1257 (US Court of Appeal for the Sixth Circuit), available at: dir.yahoo.com/government/law/cases/
- 6 *Bensusan Restaurant Corp. v. King* (1996), 1383 (US Court of Appeal for the Second Circuit), available at: www.bna.com/e-law/cases/bensus2.htm/
- 7 *Inset Systems Inc. v. Instruction Set Inc.* (1996), Civil Action No. 3:95 CV-01314 (AVC), (US District Court for the District of Connecticut), available at: www.bna.com/e-law/cases/inset.htm/
- 8 *Zippo Manufacturing Com. v. Zippo.com* (1997), Civil Action No. 96-397 Erie (US District Court for the Western District of Pennsylvania), available at: www.bna.com/e-law/cases/zippo.htm/
- 9 *Blackburn v. Walker Oriental Rug Galleries* (1998), Civil Action No. 97-5704, (US District Court for the Eastern District of Pennsylvania), available at: www.bna.com/e-com/cases/blackburn.htm/
- 10 UCC Article 2B 2B-107, available at: www.law.uh.edu/ucc2b/080198/080198.html
- 11 See www.hcch.net/e/conventions/draft36e.htm
- 12 See www.ecommerce.gov/PressRelease/ecom-01.html
- 13 State Council Order No. 273.
- 14 Extracts from South Net – South City Paper, August 4, 2001, available at: www.sina.com.cn

References

- Ayres, I. and Gertner, R. (1989), "Filling gaps in incomplete contracts: an economic theory of default rules", *Yale Law Journal*, Vol. 99, pp. 271-306.
- Baecelo, J.R. (1999), "A new legal framework for electronic commerce: the EU electronic commerce proposal", *Computer Law & Security Report*, Vol. 15, pp. 147-58.
- Calabresi, G. and Melamed, D. (1972), "Property rights, liability rules and inalienability: one view of the cathedral", *Harvard Law Review*, Vol. 85, pp. 1089-128.
- China Youth Daily* (2001), 20 February.
- Chissick, M. and Kelman, A. (1999), *Electronic Commerce: Law and Practice*, Sweet & Maxwell, London.
- Coase, R.H. (1937), "The nature of the firm", *Economica*, Vol. 4, November, pp. 386-405.
- Coase, R.H. (1960), "The problem of social cost", *Journal of Law and Economics*, Vol. 3, pp. 1-44.
- Doebele, J. (2000), "B2B for the little guys", *Forbes*, July 24.
- Elkin-Koren, N. and Salzberger, E.M. (1999), "Law and economics in cyberspace", *International Review of Law and Economics*, Vol. 19, pp. 553-81.
- European Communities Commission (ECC) (1988), *Convention on Jurisdiction and the Enforcement of Judgment in Civil and Commercial Matters*, 88/592/EEC (Brussels Convention), ECC, Brussels.
- European Communities Commission (ECC) (2000), *Council Regulation on Jurisdiction and the Recognition and*

- Enforcement of Judgements in Civil and Commercial Matters*, COM (2000) 689 final, ECC, Brussels.
- European Union (EU) (1980), *EC Convention on the Law Applicable to Contractual Obligations (Rome Convention 1980)*, 498Y0126(03), EU, Brussels.
- Global Information Infrastructure Commission (GIIC) (1999), *A Global Action Plan for Electronic Commerce*, 2nd ed., GIIC, Washington, DC.
- Goldstein, A. and O'Connor, D.E. (2000), "E-commerce for development: prospects and policy issues", Technical Papers No. 164, OECD Development Centre, Paris.
- Hoskins, J. and Lupiano, V. (1997), *Exploring IBM's Bold Internet Strategy*, Maximum Press, Gulf Breeze, FL.
- International Chamber of Commerce (ICC) (1997), *Electronic Commerce in Practice, The World Business Agenda for Electronic Commerce*, ICC, New York, NY.
- Mckenzie, P.D. (2000), *Electronic Commerce – People's Republic of China*, Perkins Coie LLP, Seattle, WA, available at: www.perkinscoie.com/resource/ecomm/prc.htm
- OECD (1997), *Electronic Commerce: Opportunities and Challenges for Government (The "Sacher Report")*, OECD, Paris, June.
- OECD (1999), *The Economic and Social Impacts of Electronic Commerce: Preliminary Findings and Research Agenda*, OECD, Paris, June.
- People's Daily* (2000), "China's e-commerce becomes reality", May 9, available at: http://english.peopledaily.com.cn/200005/09/eng20000509_40379.html
- Pindyck, R.S. and Rubinfeld, D.L. (1998), *Microeconomics*, 4th ed., Prentice-Hall, Upper Saddle River, NJ.
- Stallings, W. (1995), *Network and Internetwork Security Principles and Practice*, Prentice-Hall, Englewood Cliffs, NJ.
- State Economic and Trade Committee State (2001), *Report on the Investigation of Enterprises' Internet Application and E-commerce Development in China*, State Economic and Trade Committee, 19 December.
- UltraChina.com (2000), "The dilemma of e-commerce development in China", August 11, available at: www.UltraChina.com
- United Nations Conference on Trade and Development (UNCTAD) (2002), *Trends and Executive Summary, E-commerce and Development Report 2001*, UNCTAD, Geneva, p. 55, 57.
- Williamson, O.E. (1981), "The economics of organization: the transaction cost approach", *American Journal of Sociology*, Vol. 87 No. 3, pp. 548-77.
- Williamson, O.E. (1985), *The Economic Institutions of Capitalism*, Free Press, New York, NY.
- World Trade Organization (WTO) (1998), *Electronic Commerce and the Role of WTO*, May, WTO, Geneva.
- Zhang, W. (2000a), "Is he Alibaba's secret? Interview with John Wu", *e21times*, October 11, available at: <http://english1.e21times.com/asp/ppd.asp?r=717>
- Zhang, W. (2000b), "Interview with Jack Ma (part 3)", *e21times*, July 3.
- Zhang, W. (2000c), "Interview with Jack Ma (part 4)", *e21times*, July 3.
- Zhang, W. (2000d), "Interview with Jack Ma (part 5)", *e21times*, July 3.

Further reading

- OECD (2000), *OECD Economic Outlook*, OECD, Paris.
- United Nations Conference on Trade and Development (UNCTAD) (2001), *Trends and Executive Summary, E-commerce and Development Report*, UNCTAD, Geneva.