



Model of the Internet Escrow's Legal Regulation as a Factor of Efficiency of Its Use in E-Commerce

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Abstract. The global e-commerce market continues growing year by year. Alongside, low confidence of consumers in sellers on the Internet and electronic platforms remains one of the key issues predetermining relevance of the researches focused on looking for the tools to solve the issue of confidence between the e-commerce participants. Internet escrow is among those tools. In contemporary literature, the focus is mainly on the economic assessment of its use, while the efficiency of using the Internet escrow depends largely on the legal regulation in the relevant legal system. The research deals with the models of the Internet escrow's legal regulation in the USA, where it has been settled long enough, and in the Russian Federation, where the legal and regulatory base in the relevant area is only at the initial stage of development. The aforesaid analysis renders it possible for us to identify the major “strong” properties of escrow, providing for efficiency of its use in e-commerce. The characteristics of various legal escrow models as presented in the research can be used as a criterion for choosing the escrow agent from among both the Russian and international companies offering the relevant services.

Keywords: Beneficiary · Confidence · Depositor · E-commerce
Escrow account · Escrow agent · Internet escrow · Legal model
Nominal account

1 Introduction

The size of the e-commerce market goes on growing worldwide steadily over the past few years. According to the analytical agency We Are Social, contained in 2018 Digital Yearbook [1], being the report on the global digital market, the total amount of the global e-commerce market for consumer goods in 2017 increased by 16% and made almost USD 1.5 trillion. At the same time, the number of people around the world using the e-commerce platforms grew by 8%, and made almost 1.8 bln persons.

The Russian e-commerce market is even slightly ahead of the world average rates. Thus, according to the forecasts of the research agency Data Insight [16], the growth of the domestic Russian online sales of tangible goods in 2018 will be 18%, and the market size will go up to RUB 1.115 billion (the market growth in 2017 was 18%, in 2016: 23%).

Alongside, the consumer confidence in the Internet sellers and electronic platforms remains to be one of the key factors influencing development of e-commerce. The public opinion poll concerning confidence in e-commerce services as carried out by the Regional Public Organization "Internet Technologies Centre" (ROCIT) in early 2018 showed that 63% of respondents chose that they had fear for their security among the reasons for refusing to make purchases on the Internet, as well the major fears were associated with the possibility of the bank card or e-wallet data theft (80%) or with the shop's denial to deliver the already pre-paid goods (80%) [12]. In this light, examination of the tools solving the issue of confidence in e-commerce is rather relevant.

One of the above tools is the Internet escrow, enabling to secure transactions between the network users. The funds of the parties to the obligation are placed under control of an independent third party (escrow agent), which holds and releases them only after the obligation has been completed and both the parties are satisfied.

The escrow agent checks the funds transferred by the buyer and keeps them on the special escrow account. The seller sends the goods only after the buyer has made the full payment to the escrow account. The escrow agent tracks the goods to make sure they are delivered on time. The seller does not receive the payment until the buyer accepts the goods and is able to check them comprehensively. As soon as the buyer has checked and accepted the goods, the funds from the escrow account will be transferred to the seller. If the goods fail to arrive to the buyer within the time specified or they have got defects, the funds will be returned to the buyer after sending the goods back to the seller. During the above period, none of the parties is entitled to dispose of the funds on the escrow account.

The aforesaid services become more and more popular all around the world in recent times. Among the largest global players, one can distinguish Escrow.com, a company which as of 2017 reached the amount of USD 2 billion in secured transactions [11]. Successful use of the Internet escrow in Russia would contribute to further development of e-commerce through reducing the risks on the part of its participants, as well as through the overall enhancement of confidence in Internet transactions. However, it requires, above all, confidence particularly in the applicable model of escrow, which might be ensured by the transparent legislative regulation and high level of professionalism of the escrow agents providing the relevant services. Otherwise, the Internet escrow's use can achieve an adverse effect, instead of the positive one, by becoming another fraudulent tool.

There has been almost no escrow legal regulation in Russia until recent times. Some regulations concerning escrow accounts were fragmentary introduced into the Russian law as late as in 2014; and the regulations in the Civil Code of the Russian Federation governing the escrow agreement took the effect only from 01.06.2018. However, the features of rendering escrow services on the Internet have not been separately recorded in the legislative regulation of the Russian Federation yet. With that, the above situation was not a hindrance for domestic companies to offer sundry services of the secured or protected transactions on the Internet actively: SafeCrow, Escrow.WebMoney, "Safe Deal" from Yandex, "Guaranteed Settlement Service" from Sberbank and some others.

Within the framework of globalization of the world, especially through the Internet, competitiveness of the legal system may become crucial for choosing the most reliable escrow agent, and, as a consequence, become a factor in formation of the unique “safe havens” for global players of the Internet escrow services. It is not too much of a leap to imagine that the international e-commerce participants will opt for, when choosing a mediator in their transactions, the escrow agent, the activity of which is settled as transparently as possible by the state, where such agent operates, and the legislative model of which allows the escrow agent’s clients to be protected, to the greatest degree, from potential abuses of that agent.

It appears that assessment of such models is vital for building an efficient and competitive escrow structure in Russia. In this regard, it may be of relevance to assess the Russian escrow services market’s conditions as for its compliance with the Russian law in this area, which law has emerged almost from scratch, and also to compare it with the escrow models on the Internet in other legal systems, which models are being successfully implemented internationally.

2 Materials and Methods

The major research method is the comparative-legal analysis of the US law, where the escrow, including on the Internet, has been settled long enough and with most details, thereby making it possible to successfully use escrow in e-commerce, and the law of the Russian Federation regarding escrow, the formation of which has just begun. The aforesaid analysis enables identification of the key “strong” properties/features of escrow, determining its active use in the USA.

Through the prism of the US Internet escrow legal regulation model, the research deals with the Russian law in this area, identifies similar and missing elements. Further, the existing Internet escrow services in Russia are assessed in the context of the identified major structural characteristics both in the Russian and US legal systems.

From a practical point of view, the characteristics of various escrow legal models presented in the research can be used as a criterion for choosing an escrow agent from among both the Russian and international companies offering the relevant services.

3 Results

3.1 Internet Escrow in the USA

One of the most successful escrow models is the model developed in the United States or more precisely in the State of California. Other countries frequently take the rules proposed by the Californian lawmakers as a basis for their own legislation. The Californian escrow law (the so-called Escrow Law) means the regulations contained in the Division 6 (commencing with Section 17000) of the California Financial Code and Subchapter 9, Title 10, California Code of Regulations commencing with Section 1700 (10 C.C.R. § 1700, et seq.).

The active regulation of Internet escrow in the State of California began as early as in 2000, when the number of complaints in the area of e-commerce increased significantly and the regulators realized that Internet escrow companies could reduce the risks of consumers ordering goods and services via the Internet.

The logical conclusion was that all the Internet escrow companies had to follow the rules prescribed for ordinary escrow agents [5]. However, the Californian law still contains some clarifications with regard to the Internet escrow. Thus, in accordance with Section 17004.5 of the California Financial Code, the Internet escrow agent means an entity carrying out escrow transactions via the Internet.

Paragraph 1737.1 of the California State Code (§ 1737.1. Internet Escrow Agent Special Accounts) prescribes the basic rules for regulating the special accounts as used by the Internet escrow agents in their activity.

1. The deposited funds shall be placed, within the following working day, by the escrow agent to the special bank account (trust account or escrow account). Only the deposited funds can be available on that account.
2. The Internet escrow agent may not dispose of the deposited funds before placing them to the bank trust or escrow account.
3. The Internet escrow agent shall create the reserve fund in the minimal amount of 10% from the average monthly receipts to cover the losses that may be caused by use of credit cards, including the chargebacks, fraudulent practices, etc.

Besides, it should be noted that escrow services in California are subject to mandatory licensing by the Department of Business Oversight. Section 17210 of the California Financial Code sets the minimum capital of an escrow agent to be no less than USD 50 000, including USD 25 000 in liquid assets. Moreover, in order to obtain the license, an escrow agent shall provide the pledge or guarantee amounting from USD 25 000 to 50 000 in favour of the Department of Business Oversight and also insure liability for at least USD 125 000 against damages by fraudulent or wrongful actions of any official or "trustee" of the escrow agent.

Among other things, the requirements have also been made for the escrow agent's employees: they all have to pass through tests as for previous involvement in fraud, embezzlement or misappropriation of property. Further, the escrow-agent's manager should have minimum 5 years of experience in the escrow area.

The escrow agent's activity is still supervised by the Department of Business Oversight following issuance of the license: the annual reports of the escrow agent, as well as the regulatory licensing examination once per 2–4 years are required.

Naturally, the above strict licensing requirements to the escrow agent contribute to increase of confidence both in it and in the escrow system as a whole.

The escrow agent is a professional participant of the escrow services market and is subject to compulsory licensing and license control, therefore it has the incremented responsibilities in relation to its customers corresponding to this level (more detailed examination was made by Tokmakov, 2017 [14]). It appears that particularly the aforesaid approach of the American law to the escrow agent has determined, to a large extent, efficiency and relevance of escrow both in e-commerce and in other areas of the economy. Incidentally, the official website of the Californian Department of Business Oversight informs, in free access, about all the Internet escrow companies licensed to

provide online escrow services in the State of California: there are only three of them (including the above-mentioned Escrow.com)! And this point emphasizes not monopolization of the Internet escrow market, but the regulator's thorough and careful selection of the entities rendering such services in order to prevent the possible negative consequences for consumers.

Thus, the US Internet escrow model's efficiency is achieved through the following key components:

1. The escrow agent's activity is subject to licensing. The licensing requirements contain the incremented financial and professional criteria.
2. Escrowing of funds is achieved through entrance into a trilateral agreement between all the parties to the transaction.
3. The funds are deposited on a special account in the escrow agent's bank.
4. The deposited funds have a separate regime: none of the parties (including the escrow agent) is entitled to dispose of the funds before the conditions stipulated in the contract are met and the funds cannot be foreclosed under the claims of creditors of any party.

3.2 Internet Escrow in Russia

Analysis of the Russian law renders it possible to conclude that at present there is no special legal and regulatory base for Internet escrow yet. There are not any requirements for the escrow agent among the general regulations concerning escrow either, which fact is, to a large extent, based on absence of the exclusive list of the entities authorized to provide the escrow agent services.

However, with regard to the Internet escrow, there are still some provisions that can be mentioned. The Civil Code of the Russian Federation acknowledges the escrow agreement as an agreement, whereunder one party (the depositor) undertakes to deposit the property to the escrow agent, and the escrow agent is obliged to keep it and transfer it to the other party (the beneficiary) provide that certain conditions are met (clause 1 of the Article 926.1 of CC of RF). Alongside, the escrow agreement is the trilateral one and it shall indicate, as an essential condition, the depositing term, which may not exceed five years.

One can deposit movables, non-cash funds and non-documentary securities (clause 3 of the Article 926.1 of CC of RF). With that, the deposited property shall be separated from the property of the escrow agent (clause 1 of the Article 926.4 of CC of RF). None of the parties is entitled to use and dispose of the deposited property.

The deposited non-cash funds are separated through opening the special bank accounts: escrow account, if the escrow agent is a bank, or nominal account, if the escrow agent is not a bank (clause 3 of the Article 926.7 of CC of RF). Such use of the special accounts ensures safety of funds against foreclosure, arrest or interim measures in respect of the escrow agent's or depositor's debts. Thus, it can be stated that the Russian escrow model has generally perceived the positive global experience. Most of the above escrow efficiency criteria (three of four) are also peculiar for the Russian law. However, it is obvious that probably the most principal and strategic criterion, licensing of escrow agents, is not available.

Under the Russian law, currently the escrow services can be provided by any entity without any additional requirements. This situation has emerged particularly at the same time with commencement of the new regulations of the Civil Code of the Russian Federation concerning the escrow activity from 01.06.2018. Before that time, only the banks within the bounds of the escrow account's agreements could act as an escrow agent. Naturally, such closeness in the circle of escrow agents was out of line with the global experience or with the essence of the escrow's structure, which fact was repeatedly criticized [10]. However, the way this problem is solved today, as it appears, raises even more questions. For successful development of the escrow services market in Russia, this obvious gap in regulation of the escrow agents' activity shall be eliminated as soon as possible. Escrowing as designed to be a reliable tool on reduction of risks and intensification of confidence can on the contrary become, if the subjects acting as escrow agents are chosen wrongfully, a tool replicating the risks and undermining confidence in the entire escrow institution.

Nevertheless, even without taking into account the incremented requirements to the escrow agent on the part of the Russian legislator, it is possible to form the criteria showing the Russian model of the Internet escrow:

1. Escrowing of funds is achieved through the trilateral escrow agreement between all the parties to the transaction (escrow agent, depositor and beneficiary).
2. The escrow agent (if it is not a bank) shall open a nominal account in the bank in its name and indicate the depositor and the beneficiary under the escrow agreement as beneficiaries to the nominal account.
3. Such placement of funds on the nominal account forms a separate regime for them: none of the parties (including the escrow agent) is entitled to dispose of them before the conditions stipulated in the contract are met and the funds cannot be foreclosed under the claims of creditors of any party either.

Only the above structure, combining all the indicated features, can give according to Russian law the legal effect, which is peculiar for escrowing.

Assessment of the escrow services offered by the Russian Internet services at the e-commerce market leads to the conclusion that none of them (of which we know, at least) is in line with the developed escrow model. In most cases, the deposited funds are placed not on the nominal accounts, but on the ordinary settlement accounts of the companies; the escrow agreement is substituted for the service agreements and contracts of agency, etc. With this approach, formally, references to provision of escrow services on the web-sites of such Internet services and as a whole usage of the term "escrow" can mislead consumers, which hardly matches the good faith. Such a situation may undermine confidence not only in those who offer the said services, but, even worse, in the area of escrow services, which is just emerging in Russia.

4 Discussion

One should mention a lack of attention to the problems associated with the Internet escrow, not only from the legislator, but also from the science and professional community. A lot of works in the Russian legal literature are devoted to studying

escrow, however they, as the institution is young, raise the escrow issues in general and are not focused on a separate examination of the Internet escrow [3, 15]. The American legal literature has the similar situation, oddly enough [4, 8].

At the same time, an active discussion of the Internet escrow's use in e-commerce is held among the economists. Models of the escrow efficient use at online auctions [7, 9] and strategies to form confidence in online platforms [6] are being developed; the impact of using escrow on intensification of confidence and reduction of risks of the e-commerce participants is estimated [2, 13].

However, it seems that efficiency of using the Internet escrow largely depends not only on economic factors, but also on the escrow's legal regulation in the relevant legal system. The properly selected legal escrow model may meet the needs of the e-commerce participants, take into account the balance of their interests and solve the issue of confidence, thereby encouraging development of e-commerce and acquiring a specific economic effect.

5 Conclusions

The tools, creating the safe conditions of property exchange for participants, solving the issues of fear of the first performance and of various abuses subject to practical impersonality of the counterparty on the Internet, are among the key factors for development of e-commerce. Internet escrow is one of those tools.

However, the Internet escrow can cope with the problems in a successful and effective manner, provided that only there is a properly developed model of legal regulation in the relevant legal system. The legislator's gaps may invoke a lack of interest on the part of e-commerce participants in the proposed escrow services, or choice preference in favour of the escrow services regulated by another legal system, being a certain economic threat to the relevant state. It is completely unacceptable for Russia under the conditions of the global competition and sanctions policy.

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