New Federal Law Takes Effect That Gives Legal Validity to Electronic Signatures and Records

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The Electronic Signatures in Global and National Commerce Act ("E-Sign") became effective on October 1, 2000, giving electronic signatures, contracts and records the same legal validity as equivalent paper signatures, contracts and records. As a result, E-Sign removes much of the uncertainty that has hindered many transactions in the E-commerce arena.

Most significantly, E-Sign establishes a general rule that validates electronic signatures and electronic records used in *any* transaction in and affecting interstate and foreign commerce. It also creates uniformity among differing state laws, and is technology neutral, which enables the parties to a transaction to choose the form of electronic signature or electronic record best suited for their purposes.

These important points as well as some practical implications of E-Sign are set forth below.

Use of Electronic Signatures and Records

E-Sign broadly provides that a signature, contract or other record relating to a transaction may not be denied legal effect, validity or enforceability solely because it is in electronic form or is executed via an electronic signature. In regard to signatures, E-Sign does not require that an electronic signature necessarily be an actual signature in electronic form. A transaction can be consummated in any electronic manner so long as the parties express some form of acknowledgment that they wish to conduct the transaction electronically, such as clicking on an 'I agree' icon. Indeed, E-Sign defines an electronic signature as an "electronic sound, symbol or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record. "

E-Sign does not require any person to use or accept electronic records and signatures, and E-Sign only modifies existing law to the extent that the law contains requirements that contracts or other records be written, signed or in a non-electronic format. For instance, some Federal and State statutes require "paper and ink" signatures for certain insurance and financial contracts or that certain disclosures be provided in writing or provided in paper form. Generally, E-Sign trumps these laws, unless they fall within certain exceptions defined below.

Exceptions

Under E-Sign, certain documents will still have to be manually signed on paper, as E-Sign does not apply to the following:

- Wills, codicils, or testamentary trusts

Contracts or other records regarding family law issues such as adoption and divorce

- Court documents such as pleadings, notices and briefs.
- Notices concerning the cancellation of utility services or life or health insurance benefits
- Default, acceleration, repossession, foreclosure, eviction, or cure notices under residential leases or under home equity loans
- Product safety recall notices
- Documents relating to the shipping and handling of hazardous waste .
- Certain types of contracts or other records governed by the Uniform Commercial Code (UCC), such as Article 3 (commercial paper), Article 4 (bank deposits and collections), and Article 9 (secured transactions)

E-Sign does cover UCC §1-107 (waiver of claims after breach), §1-206 (statute of frauds for personal property), Article 2 (sale of goods) and Article 2A (leases of goods).

Also, while E-Sign does not apply to the documents listed above, a law addressing any of these types of documents may provide for electronic delivery. Moreover, the Secretary of Commerce is charged with the duty to review federal law and determine where amendments should be made to eliminate these exceptions.

Preemption of State Laws

E-Sign expressly preempts state laws that address electronic transactions. There are principally two types of state electronic laws: (1) the Uniform Electronic Transactions Act ("UETA") as adopted by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), and (2) more general state electronic records and electronic signatures laws. The E-Sign preemption provisions provide that these state laws can only supersede the provisions of E-Sign if either the state law is an enactment of UETA as adopted by NCCUSL, or the provisions of the non-UETA state law or the UETA enactment that differs from NCCUSL's version are not inconsistent with those of E-Sign and do not accord greater legal status or effect to a specific form of technology or signature.

While several theories regarding the interpretation of E-Sign preemption provisions have been raised, we believe that the best interpretation will be:

1) Those provisions of a state UETA that mirror NCCUSL's version will not be preempted by E-Sign.

2) Non-conforming NCCUSL provisions of a state UETA will be preempted if they are inconsistent with E-Sign or are not technologically neutral.

3) Every provision of any non-UETA state law relating to electronic transactions will be preempted if they are inconsistent with E-Sign or are not technologically neutral.

Of course, in some instances an entire non-UETA state law relating to electronic transactions will be preempted. For example, the digital signature laws enacted in some states, such as Utah, will be entirely preempted because the Utah digital signatures act does not validate all types of electronic signatures like

E-Sign, and is not technologically neutral because it requires the use of specific technology to create and use electronic signatures and electronic records.

In addition, any exception to the scope of UETA enacted by a state is preempted to the extent such exception is inconsistent with E-Sign, or would not be permitted under the "inconsistent" or "greater legal effect" test. For instance, those states that have adopted versions of UETA that contain express exclusion from the scope of UETA for certain mortgage or real estate related activities, which are not in the express exclusions contained in E-Sign, are preempted.

Second, a state law may not circumvent E-Sign through the imposition of non-electronic delivery methods under a carve out in UETA that allows a state to override UETA's electronic delivery requirements where a state has another law specifying the delivery requirements (*e. g.* , certified mail or posting of a notice). Therefore, a state may not enact a law to circumvent the electronic delivery authority provided by E-Sign. Presumably, existing laws requiring non-electronic delivery methods are not preempted since they could not have been created to circumvent the statute. New legislation will have to overcome a greater burden of proof that there is another purpose for enacting the statute.

UETA

To date, twenty-three states have enacted UETA. Eighteen states have enacted UETA without any relevant changes from the NCCUSL model. While the enacted version of UETA in these states may contain some differences from the NCCUSL model, it is generally understood that some minor variation in the NCCUSL version of UETA will be tolerated provided the differences are non-substantive and are included merely to conform to idiosyncrasies of that state's law.

While UETA and E-Sign overlap significantly, UETA is more comprehensive than E-Sign. For example, E-Sign only provides for limited electronic analogs to paper negotiable notes in transactions secured by real property. The provisions of UETA, however, are broader in scope, applying to all documents, which would, if on paper, be either a promissory note under UCC Article 3 or a document of title under UCC Article 7. Thus, if a transportation or storage company is doing business in a UETA jurisdiction, these companies can develop and use electronic records for interests in property or claims for debt instruments not based on real property collateral.

Perhaps the most significant difference between UETA and E-Sign relates to how the two statutes deal with consumer protection issues. E-Sign focuses on regulating the manner of consent to deal electronically, while UETA focuses on what the information provider must do to comply with state law requirements for notices, disclosures, and information. UETA preserves the requirements concerning the manner of sending, posting, displaying, formatting contained in state law. For example, under UETA, if other laws require information to be furnished in a conspicuous manner with red sprinkled with glitter, the information provider can furnish the information electronically only if it can assure that it appears to the recipient in a conspicuous manner in red sprinkled with glitter.

While the differences between UETA and E-Sign are too numerous to list in this White Paper, we urge all companies considering rolling out an digital signature program to consult with their contact at Morgan Lewis to obtain specific advice on applicable state laws that companies need to consider in formulating their electronic signature and records program.

Technology Neutral Law

E-Sign does not impose technical standards for conducting electronic transactions or verifying electronic signatures. Rather, it allows the parties to determine the electronic procedures and authentication requirements they will use. These requirements should be memorialized in an agreement between the parties. Various technologies are now available that could qualify as electronic signatures and satisfy the requirements of E-Sign.

Consumer Protections

E-Sign provides for onerous requirements in the context of consumer transactions where existing laws require that the consumer receive certain information in writing. In such cases, consumers must affirmatively consent to the use of electronic media before a business commences an electronic transaction with a consumer. Moreover, before consenting, the consumer must be provided with a "clear and conspicuous statement" that informs the consumer of specific information such as the right to withdraw consent, the right to obtain paper copies of transactions documents, and a statement on hardware and software requirements for accessing and retaining electronic records. The consumer needs to consent electronically or confirm his or her consent electronically in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used by the company to provide the information.

Government Agency Interpretations

Federal and state agencies may interpret the requirements of E-Sign law by adopting regulations, orders or guidance. A federal regulatory agency may, by regulation, exempt a specific category or type of record from the above-explained consumer consent requirement if such exemption is necessary to eliminate a substantial burden to electronic commerce and will not increase the material risk of harm to consumers. Issues have arisen regarding the extent to which E-Sign also preempts existing regulations and interpretations of federal agencies with respect to electronic delivery of documents. For example, the Securities and Exchange Commission has issued a series a interpretations regarding electronic dissemination of disclosure documents under the federal securities laws. Morgan Lewis will be monitoring these new interpretations by federal and state agencies but we urge you to contact us if you have specific questions on how any new regulations, orders or guidance may impact your business.

Record Retention

E-Sign also contains requirements for electronic record retention. E-Sign defines an electronic record as a record created, generated, sent, communicated, received or stored by electronic means. Under E-Sign, if a law requires that a contract or record be retained, an electronic version of the document will suffice only if (i) the electronic document accurately reflects the information in the contract or record; and (ii) the electronic document is accessible to all relevant parties in a form that may be accurately reproduced at a later date by printing, electronically transmitting, or by other means. For example, if a law requires that a check be retained, an electronic record that contains the information on the front and back of the check will satisfy the requirement.

In practical terms, companies must work with their information technology vendors to ensure that software for the electronic records program of the company complies with applicable record keeping requirements under E-Sign and other state laws. Fortunately, the electronic record keeping provisions of E-Sign will only be effective on March 1, 2001 for any federal statutory and regulatory requirements in existence at that time, and on June 1, 2001 for any record keeping requirements that are part of a federal agency's rulemaking that has been announced but not completed by March 1, 2001. Morgan Lewis will continue to monitor federal and state electronic record retention requirements and we urge you to contact counsel as your company implements an electronic record retention program to ensure compliance with applicable laws.

International Electronic Signature Laws

While E-Sign does not apply to foreign companies transacting business in foreign countries, it does apply to foreign companies doing business in the U.S. Moreover, many U.S. companies doing business abroad face uncertainty regarding the validity of electronic signatures. While many European and Asian countries have passed digital signature laws, there continues to be different standards and exceptions.

Companies doing business abroad will also need to consult with counsel to determine the laws of foreign nations and verify that their electronic signature and records program do not violate local laws.

Conclusion

While E-Sign encourages online contracting, many companies still need to consult counsel and information technology experts to develop systems and procedures that prove that electronic records have not been tampered with, that the electronic signatures are accurate and secure. The short message to clients is that while E-Sign overcomes prior legal uncertainty in many areas, there are other issues that must be addressed. Companies and individuals need to be diligent in developing effective procedures as the use of electronic signatures in contracting significantly increases over the next few years. If you have any questions relating to how these new laws and regulations on electronic signatures and records affect your business, please feel free to contact any one of the lawyers listed below:

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