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“The Regulation of Electronic Contracts”

by

Keith Jenkins, JD
Associate Professor, Sam Houston State University
College of Business Administration

and

Charles R.B. Stowe MBA, JD, Ph.D.
Professor, Sam Houston State University,
College of Business Administration

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The Regulation of Electronic Contracts

Keith Jenkins and Charles R. B. Stowe¹

Abstract

Over the past decade, the internet and its world wide web have created a “new economy” of billions of dollars of transactions. This article explores the issues relevant to the regulation of electronic contracts specifically addressing the issue of what constitutes an enforceable signature when such assent is not made in person but through transmission of a message via the internet. The State Law Commissioners during the summer of 1999 issued the Uniform Electronic Transactions Act (“UETA”) and the Uniform Computer Information Transactions Act (“UCITA”). Pennsylvania claims to be the first state to enact the Uniform Electronic Transaction Act.¹ Maryland was the first state to enact the Uniform Computer Information Transaction Act.² Ultimately all state legislatures will be considering both pieces of legislation.³ This brief overview should be of interest to those engaged in electronic commerce or in teaching contract law.

Introduction

In the fourth quarter of 1999, the U.S. Department of Commerce reported that retail sales over the internet were \$5.3 billion. A private study conducted by Forrester Research of Cambridge, Massachusetts placed internet retail sales at \$10 billion or nearly double the government’s estimate.⁴ While only a small percentage of the \$812.2 billion of total U.S. retail sales for the quarter, internet retailing is coming of age. Worldwide internet sales were at almost \$23 billion in 1999. Street estimates for worldwide sales in the year 2002 are approximately \$105 billion with \$65 billion in the U.S. implying an annual growth rate of 80 percent according to Bank of America’s senior internet securities analyst Tom Courtney.⁵

There are almost a limitless number of web sites some offering simple electronic presence

¹ Keith Jenkins JD, Associate Professor, and Charles R. B. Stowe MBA, JD, Ph.D, Professor, Sam Houston State University, College of Business Administration, Huntsville, Texas. Charles R. B. Stowe also serves as Director of the Office of International Programs at Sam Houston State University.

on the world's electronic billboard. Others are more elaborate with invitations to make purchases. The site that actually serve as electronic store fronts ask customers to pay by means of credit cards. But there are many other types of transactions that involve signing a contract such as lease agreements, purchasing insurance, etc. Obtaining such signatures electronically is a relatively new issue. The current Uniform Commercial Code in most states is not helpful in this regard.

As a result, electronic signature legislation and electronic contract legislation has been proposed not only by State and Federal government, but by other sovereign nations and by international organizations. At this writing, there are many conflicting policies being pursued in the area of "electronic contracting". This paper provides a brief overview of two significant legislative initiatives.

Uniform Electronic Transactions Act

Many states enacted their own electronic signature or electronic transaction statutes.⁶ The problem with state initiatives is that they differ making compliance a jurisdictional nightmare as the whole nature of the www is to permit and encourage worldwide transactions. During the summer of 1999, the National Conference of Commissioners of Uniform State Laws adopted a the Uniform Electronic Transactions Act as a national standard for electronic signature legislation⁷. The proposed act "applies to electronic records and electronic signatures relating to a transaction."⁸ The Act provides for quite a few exceptions including laws governing the creation and execution of wills, codicils, or testamentary trusts, major portions of the Uniform Commercial Code other than Sections 1-107 and 1-206, Article 2 and Article 2A (meaning that rules relating to signatures for banking (Articles 3 and 4), secured transactions (Article 9), warehouse receipts, investment securities, etc are not covered. The act does not apply to other laws identified by the State (which may include specific consumer protection statutes, for example). Otherwise, the act broadly states that electronic signatures are valid and electronically generated contracts satisfy the Statute of Frauds. The electronic signature is defined as any "electronic sound, symbol, or process attached to or logically associated with a record and

executed or adopted by a person with the intent to sign the record.”⁹ The significance of this provision is that the authors were trying to anticipate current and future technological developments for “voice prints” and other forms of signatures beyond that of an electronic version of a handwritten signature. The key element of whether an electronic signature is valid is whether the electronic record is capable of being retained by the recipient at the time of receipt. If the sender or its information processing system can inhibit the ability of the recipient to print or store the electronic record, then the transmission is not an electronic signature. The term “electronic signature” includes facsimile, electronic mail, voice mail, audio, records, as well as internet transmissions both encrypted and nonencrypted. However, a critical element is that the party intended to make the signature. A mereclick on “I agree” will suffice to show intent. Even typing ones’ name on an email message may act as a valid signature or applying a biometric or encryption technology to a message with the intention to sign is sufficient. The Act does not require a transmission to replicate a handwritten signature. While this may sound radical, recall that the UCC provides that a stamp or mark may serve as a signature.¹⁰ Courts have also concluded that names on telegrams, names on telexes, typewritten names, names on Western Union Mailgrams and even names on letterhead may serve as signatures.¹¹ The Uniform Electronic Transactions Act takes a very liberal approach as to what is a signature that is consistent with the UCC and court cases.

The Act deals with the issue of what happens if there is a change or error in an electronic record during the course of a transmission. If the parties have agreed to use a security procedure to detect changes or errors and one party has conformed to the procedure but the other party hasn’t, and the nonconforming party would have detected the change or error had that party also conformed, the conforming party may have the affect of the changed or erroneous electronic record. In the event that a third party “electronic agent” is used, an individual may avoid the transaction if the electronic agent did not provide an opportunity for the prevention or correction of the error and if at the time that the individual learned of the error the individual promptly notified the other party that they did not intend to be bound by the electronic record, and they took reasonable steps to return or consideration received, and they have not already received any benefit or value from the consideration if any, received from the other person so long as they

were created with intent.¹²

When a legal document requires notarization or acknowledgment, a notary may use an electronic signature along with any required language.¹³ The Act also provides that if a law requires that a record be retained, that requirement may be satisfied by retaining an electronic record of the information so long as the record remains accessible for later reference and so long as the information set forth in the record accurately reflects the information set forth in the record after it was first generated. The Act even provides that when the law requires an "original", the electronic record will fulfill that requirement.¹⁴ A State agency may set additional requirements for the retention of a record under their jurisdiction. Such electronic signatures are admissible in evidence.¹⁵

The Act does not change the "mailbox" rule but it does set out the rules as to when a message is sent and when it is received. A message or electronic signature is considered sent when it is addressed and enters the electronic processing system outside the control of the sender or if it enters the region of the information processing system designated or used by the recipient which is under the control of the recipient.¹⁶ An electronic message is deemed to be received when it enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record and it is in a form capable of being processed by that system. The Act clearly contemplates transmission either within a corporate intranet system or through the internet whereby the message is actually transmitted in packets passing through a number of host servers. Noteworthy is the provision that a message is deemed to be received even if the recipient is unaware of its arrival. While many email systems permit a sender to receive confirmation that the message arrived, the Act acknowledges that such a notice does not indicate whether the contents sent correspond to the content received. The act permits state law to determine the legal outcome when a party is aware that an electronic record purportedly sent or purportedly received was not actually sent or received.¹⁷ The act also permits State agencies to determine whether they will create and retain electronic records and grants state agencies the right to prescribe the system and manner of sending electronic reports and signatures and encourages state agencies to develop consistent and standardized regulations concerning record

submissions.¹⁸

Overall, the Act broadly defines electronic signatures and liberally permits state agencies to prescribe their own systems or procedures for the electronic submission of reports with electronic signatures. The Act is therefore quite neutral in its effect on the rules of contracts except to encourage a system whereby contracts made over the internet will be binding upon a showing of intent of the parties to create an enforceable contract. The Act makes it fairly easy to create an indication of consent through clicking on a box that says "I agree" and leaves open the precise mechanism whereby a party would establish that they had requisite intent to form a contract.

The Uniform Computer Information Transactions Act

The Uniform Computer Information Transactions Act is a much more controversial proposal because it encompasses specific contractual rules relating to the behaviors of parties to a contract. Some perceive the proposal as being "anti-consumer." The Act not only confirms the use of electronic signatures, but actually defines contract formation and terms, sets forth rules on construction of contracts, warranties, transfer of interests and rights, defines performance and breach of contract and specifies remedies. Those familiar with the existing Uniform Commercial Code in defining relations between merchants will be comfortable with the specific provisions of the Act, while those who tend to look at transactions from the consumer viewpoint will be uneasy with the lack of specific consumer protections. Like the UCC, the Uniform Electronic Transactions Act defaults to state law for specific consumer protections. The Act was originally written as section 2b of the Uniform Commercial Code and therefore follows the UCC format.¹⁹ The American Law Institute withdrew its support of the legislation so the proposed legislation does not carry the UCC title.²⁰

The Uniform Computer Information Transactions Act does not alter any of the transactions involving the sale of goods or the leasing provisions of the UCC. It addresses only those transactions involving the licensing of software, the use of internet-based data bases or distribution of information on the Internet.²¹ Specifically excluded are transactions that would

involve the transmission of pay for view television over the internet, music downloading, and other multi-media entertainment and programs.²² The Act provides that parties may opt for having their contract treated under UCITA if they have had opportunity to indicate their consent after proper disclosure. Such consent may be included in software whereby an "I agree" button is provided at the end of a licensing or contractual agreement. In the case of shrinkwrapped contracts, the provisions are a bit more controversial in that a customer may find that they have assented to the UCITA rules after they have purchased the software. UCITA provides a partial remedy in that the customer has the right to return the software or program for a full refund if they do not wish to be held under the UCITA rules.²³ Critics of UCITA note that the FTC's model for most state consumer disclosure laws requires that the merchandisers of shrink-wrapped software provide stronger disclosure when after-purchase contract terms are to be part of a contract than UCITA's rather liberal definition of the term "conspicuous." UCITA describes 'conspicuous' as a term so written, display or presented that a *reasonable person* (emphasis mine) against which it is to operate ought to have noticed it. The Act suggests that conspicuous terms include "a heading in capitals in a size equal to or greater than or in contrasting type, font or color, to the surrounding text..."²⁴

Critics also note that UCITA's language on warranties do not adequately protect consumers. Again, the issue focuses over UCITA's definition of 'conspicuous' in that a party may disclaim implied warranties so long as such a disclaimer is conspicuous.²⁵ Another consumer protection problem is that UCITA's Implied Warranty of on accuracy of informational content does not cover "published informal content".²⁶ There are really two aspects to computer based software, the engine and the content. For example, CD-ROM based encyclopedias contain programs to play content and the actual content itself. In one sense having this limitation on liability for content makes sense using an argument that has protected film processors from liability of loss. Recall that if a film processor losses one's film, they are limited to the cost of replacement of the film itself and not for consequential damages. The justification is that film processing would become prohibitively expensive if labs were liable for the cost of recapturing the images that were lost. If computer software providers were held liable for all potential damages arising from an error in content, the risk of liability might well discourage the use of

electronic media for dissemination of information not to mention the First Amendment "free speech" arguments. On the other hand, where there is special reliance, publishers may be held liable for inaccuracies such as publishers of navigational charts.²⁷ And, issues over the potential liability arising from computer programs that may contain viruses are equally troubling to UCITA's critics.²⁸

UCITA also permits parties to treat Federal Copyright Laws as 'default' regulations in that parties may contract to alter rights that are defined under federal statutory and common law. The justification is that digital programs have very different characteristics than traditional published materials. For example, the sale of a computer program for an individual's sole use is different than say authorizing them to use the program to perform services for others.²⁹ The legal debate over the issue of whether UCITA should permit parties to circumvent federal copyright provisions is based on a more basic dispute: to what extent should law promote the burgeoning information industry versus the issues of public domain as set by copyright law.³⁰ Giving financial incentive to vendors who create both computer program 'engines' and content may well spur e-commerce. On the other hand, why shouldn't the same rules for conducting business be the same whether they are transacted on and by paper or conducted electronically? These are the issues that will continue to haunt UCITA and slow its passage by the states.

UCITA also defaults to state consumer protection statutes which in some ways leaves very uncertain certain aspects of transactions in that there is not complete uniformity among states on these issues. On the other hand, the UCC contains similar deference to state consumer laws for consumer transactions and that has not limited interstate commerce. The notion of having to comply with 50 plus versions of consumer laws may be seen as daunting, but this is exactly what Wal-Mart and other national retailers do. With electronic commerce, the significant difference is that the economic entity does not have to be terribly large to offer transactions world-wide nor must the entity have a physical presence in each state to be held liable. While the www is the entrepreneur's dream marketplace, it can also become their legal nightmare and UCITA as presently written does not give safe refuge in terms of uniformity for consumer-based transactions.

E-Commerce Examples

The www is becoming more than merely selling a books over the internet. It has the potential to alter the entire relationship between parties conducting business. A recent example is when the law firm of Hodes, Ulman, Pessin & Katz used e-Original (TM) business model, a patented process that creates negotiable, legally binding electronic documents to create an electronic lease with Advance Business Systems for some office equipment.³¹ eOriginal Inc. has patented a technology neutral process to enable the electronic creation of negotiable instruments and other critical source documents in cyberspace, and the ability to transmit store and retrieve these protected Electronic Originals (TM). The company plans on implementing a business model to enable electronic international bills of lading and has completed a pilot program for the mortgage industry where mortgage closings were processed through eOriginals (TM).³² The relationship between eOriginal and its customers who will use their patented business model software would be under UCITA although if the parties chose to enter into the agreement electronically, then UETA would also apply (assuming both are passed by the relevant jurisdictions). Another example is the joint venture between NCR Corporation and Carreker-Antinori, Inc. which propose to provide the banking industry with image-enabled electronic check presentment and exchange capabilities.³³

Conclusion

UETA and UCETA represent two efforts to address the need to establish some uniformity for e-commerce transactions within the United States. Because the United States is the leader in electronic commerce and the leader in the number and percentage of the population hooked up to the internet, US laws serve as the templates or at least as the basis of discussion for international agreements. This paper has not explored the vast differences between the European Union's attitude towards regulation of the internet. However, there is no doubt that while UETA has received a fairly warm reception in the U.S., the more complex UCETA faces a more uncertain future especially once it lost the designation as UCC Article 2B. The reality is that businesses

are moving fast to be first to develop customers and clients leaving governments and legislatures behind in pondering how and what type of contract laws should be applied to relatively new and developing transactions. While the need for uniformity may hinder growth of some enterprises, there are plenty of entrepreneurs quick to push the envelope of their activities and let the lawyers figure it out later.

For businesses, students of business law and their professors, it is critical to watch an ever changing legal landscape.

Endnotes

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2. As posted at www.mbc.com. For a complete listing of state legislation see [http://www.mbc.com/ecommerce.html#STATE INITIATIVES](http://www.mbc.com/ecommerce.html#STATE_INITIATIVES).
3. Ibid.
4. "U.S. Releases First Official Tally of Internet Retail Sales" *Los Angeles Times*, March 3, 2000 Business, Part C, p. 3.
5. "Business-to-Consumer Internet Retail Channel Positioned to Grow Substantially" PR Newswire, Financial News, San Francisco, February 4, 2000.
6. For a complete listing of those statutes see McBride, Baker & Coles website at www.mbc.com.
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8. Uniform Electronic Transaction Act Section 3, Scope as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm
9. Uniform Electronic Transaction Act Section 2, Definitions (8), as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm

10. Uniform Commercial Code Section 1-201 (3) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.
11. Smedinghoff, Thomas J. & Bro, Ruth Hill "Moving With Change: Electronic Signature Legislation as a Vehicle for Advancing E-Commerce" 17 J. Marshall J. Computer and Info. L. 723.
12. Uniform Electronic Transaction Act, Section 10 Effect of Change or Error, as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm
13. Uniform Electronic Transaction Act, Section 11, Notarization and Acknowledgment, as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm
14. Uniform Electronic Transaction Act, Section 12, Retention of Electronic Records; Originals, as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm
15. Uniform Electronic Transaction Act, Section 13, Admissibility in Evidence, as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm
16. Uniform Electronic Transaction Act, Section 15, Time and Place of Sending and Receipt, as posted at www.law.upenn.edu/bll/ulc/finact99/1990s/ueta.htm
17. Ibid.
18. Ibid.
19. The Uniform Computer Information Transactions Act, "Uniform Commercial Code Article 2B" American Law Institute and National Conference of Commissioners on Uniform State Laws, February 1, 1999,.
20. Shah, Patrik, "The Uniform Computer Information Transactions Act" 15 Berkeley Tec. L.J. 85, - Annual Review of Law and Technology. See also Ed Foster, "what is UCITA?" Last modified August 30, 1999) [http://www.infoword.com/cgi-bin/displayStory.pl.?features/990531_ucita1.htm].
21. Ibid.
22. UCITA 103 (d)(2) (Oct. 15, 1999 Draft). See also ftn 17.
23. UCITA 209 (b) and Comment notes.
24. Id. 102 (a)(14).
25. Id. 406 (b)(1)(A)

26. Shah, Patrik, "The Uniform Computer Information Transactions Act" 15 Berkeley Tec. L.J. 85, - Annual Review of Law and Technology.
27. Ftn 78 and 79 in Shah, Patrik, "The Uniform Computer Information Transactions Act" 15 Berkeley Tec. L.J. 85, - Annual Review of Law and Technology.
28. Ibid.
29. Ftn 86 "See National Car Rental Syst., v. Computer Assoc. Int'l, Inc. 991 F.2d 426, 432-33 (8th Cir. 1993) (holding that contractual restriction on processing of data for third parties constitutes an additional element distinguishing this cause of action from a copyright action)..." in Shah, Patrik, "The Uniform Computer Information Transactions Act" 15 Berkeley Tec. L.J. 85, - Annual Review of Law and Technology.
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31. "Southport Financial Announces the First Totally Electronic Lease Transaction" Business Wire, Inc. January 6, 2000.
32. Ibid.
33. "NCR and Carreker-Antinori Announce Marketing Alliance; Agreement to Provide Electronic Check Presentment with Image Exchange Capabilities" PR Newswire Association, Inc. Las Vegas, March 9, 2000.