

## CORPORATE FINANCE NEWS

**ELECTRONIC CONTRACTING AND  
RECORD RETENTION MOVE FORWARD****Michigan Enacts UETA and the Federal E-Sign Law Takes Effect**

The last of the major legal barriers to electronic contracting and record retention came down in October as new federal law went into effect and the Michigan legislature passed similar legislation. The federal legislation, called the Electronic Signatures in Global and National Commerce Act, or "E-Sign," became effective on October 1, 2000. Two weeks later, Gov. Engler signed Michigan's version of the Uniform Electronic Transactions Act ("UETA") into law.

**What Do E-Sign and UETA Do?**

E-Sign and UETA are similar in many respects. In fact, the core language of E-Sign is taken directly from UETA as promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the same language that Michigan adopted.

**Electronic Documents and Signatures**

Both laws essentially provide that a contract cannot be denied effect solely because it is in electronic form or solely because it bears an electronic signature.

Each law defines the term "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." A "record" is "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form." The definition is very broad and embraces widely differing technologies, such as a digital representation of the signer's handwritten signature, biometric signatures (e.g. voice prints, fingerprints or retinal scans) and encryption-based systems like digital signa-

tures. The legislation is intentionally technology-neutral so that contracting parties will be free to try a wide variety of technologies. E-Sign, as federal law, maintains this neutrality across state lines because it adopts this technology-neutral philosophy and expressly preempts any state law that has more restrictive requirements.

Both laws also provide that notarization requirements are met "if the electronic signature of a [notary], together with all other information required to be included by [applicable] law, is attached to or logically associated with the signature or record" being notarized.

**What Does This Mean to Me?**

- Review your sale and purchase procedures to see if you can eliminate hand signature requirements.
- Find out if your customers, suppliers, B-to-B exchanges and others will be using and/or accepting such signatures.
- If any of your Electronic Data Interchange (EDI) or electronic Trading Partner Agreements (TPAs) are imposing expensive computer infrastructure requirements, you may be able to drop them and simply contract using secure e-mail.
- Check your e-mail software package to see if it is compatible with electronic signature systems. If it is not, think about upgrading now or at least specifying it for your next system or upgrade.
- Identify people in your purchasing and sales organizations who will need electronic signatures.
- Identify electronic signature and certificate providers.

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- Make sure your information technology staff understands the infrastructure requirements.

## Electronic Agents

According to both E-Sign and UETA, an electronic agent is “a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performances...without review or action by an individual.” UETA provides that contracts may be formed by electronic agents even if no individual is ever aware of the transaction or reviews its terms. Further, a party’s electronic agent may enter into a contract with an individual that binds the electronic agent’s originator. In either case, the key is that the actions of the electronic agent must be attributable to the actual contracting party. E-Sign joins UETA in affirming the effectiveness of contracts entered into by electronic agents. These provisions remove doubts about the effectiveness of “click-through” agreements (in which a user of a system assents to license or other terms by clicking a button, usually labeled “I agree”) and provide a legal infrastructure for transactions entered into by expert systems and perhaps even artificial intelligence agents.

## What Does This Mean to Me?

- Survey your operations to see if you can automate parts of sales, ordering or other processes. You may be able to automate aspects of your sale or ordering process online without fear of enforceability problems.
- Review any click-through items or any other similar content on your website or other computer interface. Your organization may be bound by agreements formed or statements made as visitors click through.
- Make sure that employees and other agents are aware that they may bind themselves or the organization while on-line.

## Retention of Records

Both E-Sign and UETA provide that, if a rule of law requires that a party keep and maintain records, electronic records satisfy those requirements so long as the electronic records accu-

rately reflect the information and the electronic records remain accessible to all persons who are entitled to access. For retention purposes, electronic records satisfy any requirement that “original” documents be retained. Retaining the information from the front and back of a check satisfies requirements of law regarding retaining checks. E-Sign allows state and federal agencies to specify standards for the accuracy, integrity and accessibility of such records. If these agencies find that compelling governmental law enforcement or national security interests dictate retention of paper records, they may require recordkeepers to hold on to their paper documents, but only if doing so is essential to those interests.

## What Does This Mean to Me?

- Are you spending inordinate amounts of money for storage of paper records? Now is a good time to reevaluate your storage policies to see if you can save on storage costs by scanning your archives, throwing out the paper and keeping the documents in electronic form.
- Have your compliance and information technology staff become familiar with the law so they can make educated document retention decisions.
- Identify reputable information technology providers that can help you decide if and when to “go digital.”
- Investigate prices and terms available for conversions.

## Transferable Records

Both E-Sign and UETA provide for the creation and transfer of certain instruments called “transferable records.” UETA supports any kind of electronically signed record that would, if it were on paper, qualify as a note or a document of title under Michigan law. E-Sign only covers notes secured by mortgages on real property. Both laws go on to list the requirements for creating and trading transferable records, which boil down to maintaining a central system that identifies with certainty who holds the transferable record at any given time. This legal

infrastructure should help to create and sustain markets in the electronic counterparts of most kinds of commercial paper. The infrastructure will also improve logistical operations for those who trade in goods over long distances, where electronic warehouse receipts, bills of lading and other documents can now change hands almost instantaneously. It remains, of course, to see whether parties adopt these means of trading by creating exchanges or trade groups with standardized electronic records.

## What Does This Mean to Me?

- Determine whether your operations involve bills of lading, dock warrants, dock receipts, warehouse receipts, orders for the delivery of goods or similar documents. You or your trade organization may be able to move to a paperless documentary system for goods in transit.
- If you issue, purchase or otherwise trade in commercial paper or see a need to do so, this may allow you the opportunity to participate in a private commercial paper market once such markets are set up by trade organizations or others.

## What the New Laws Do Not Do

Most importantly, the new laws do not sound the death knell of pen-and-paper contracting. In fact, several kinds of documents still may not be effective when signed electronically. UETA, by its terms, does not apply to transactions governed by:

- Laws regarding wills, codicils or testamentary trusts; or
- The Uniform Commercial Code other than the portions dealing with certain statutes of frauds, sales or leases of goods and certain provisions dealing with notes and documents of title.

E-Sign contains the same exclusions and, further, does not apply to contracts or other records if they are:

- Governed by state laws regarding adoption, divorce or other matters of family law;

- Court orders, notices or other official court records, including briefs and pleadings;
- Consumer notices, including notices of:
  - Cancellation or termination of utility services;
  - Default, acceleration, repossession, foreclosure or eviction, or the right to cure under a rental or credit agreement regarding the primary residence of an individual;
  - Cancellation or termination of health or life insurance benefits; and
  - Product recalls; and
- Any document required to accompany the transportation of dangerous or toxic materials.

E-Sign charges the Secretary of Commerce with evaluating the federal exceptions over the next three years and reporting to congress on its findings. Federal regulatory agencies may also use the rulemaking process to eliminate these exceptions within their areas of authority.

Presumably, states are free to electronically enable the types of communications and notices excluded by E-Sign, but only to the extent that those communications and notices do not affect foreign or interstate commerce. This has the practical effect of limiting the scope of state legislation to that of E-Sign.

Neither law requires any private party to use electronic records or signatures. E-Sign and UETA apply to electronic contracts only where each of the parties has agreed to conduct transactions by electronic means. Under UETA, even a party that has contracted with another party electronically in the past cannot be required to continue contracting electronically.

The laws do not change any other substantive contract law. They deal only with the form and means of adopting and proving the terms of a contract. Other substantive law is on the horizon (two states have already adopted NCCUSL's Uniform Computer Information Transactions Act ("UCITA") and it is under consideration in five other states and the District of Columbia),

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but it will likely be adopted on a state-by-state basis with little federal intervention, unlike the provisions in E-Sign.

Neither law will have much effect on real estate or other transactions that require filings with certain units of government, at least not any time soon. UETA “does not require a governmental agency or official of this state to use or permit the use of electronic records or electronic signatures.” An electronically signed deed or mortgage is effective as between the parties to that deed or mortgage, but the document is of no use against third parties unless the relevant register of deeds records it. Until registers of deeds and similar agencies begin to accept these electronic filings, real estate and similar transactions will continue to require paper documents for at least some purposes. A limited and unscientific telephone poll of several Michigan registers of deeds revealed that none of them had immediate plans to accept electronically signed or notarized documents.

## *How E-Sign and UETA Differ*

E-Sign and UETA have several differences in addition to the ones already discussed.

### **Preemption**

As federal law, E-Sign’s effect is both greater and less than UETA. United States Constitutional considerations and E-Sign’s own terms limit its application to “transaction[s] in or affecting interstate or foreign commerce.” The federal government’s ability to regulate interstate and foreign commerce is broad, so virtually any transaction that is accomplished across the Internet will likely be covered. On the other hand, the United States Constitution limits the federal government’s role in matters that are entirely intrastate or that deal with most subjects other than commerce.

Federal preemption was one of the primary motivators for E-Sign. By the middle of 2000, individual states were already gravitating to one of three models: a strictly digital-signature-based infrastructure (as in Utah), the technology-neutral UETA (as in 18 other states as of June 30, 2000 and as in 23 other states by the time of this

writing) and measures that settled somewhere in between (as in Illinois). Without federal preemption, the result would have been an electronic Tower of Babel where the states with the most rigorous legal infrastructures would have been able to set the *de facto* standard for less rigorous states. States with no electronic signature laws, like Michigan, would have been left behind.

E-Sign does not preempt state enactments of UETA as long as those enactments stay true to NCCUSL’s original language. Departures from the NCCUSL language have to meet a fairly tough standard in E-Sign in order to avoid preemption. As a result, E-Sign will not preempt verbatim enactments of UETA, like Michigan’s, but will preempt enactments that included substantial changes, such as those enacted in California.

E-Sign’s preemption extends to the insurance industry and the law contains the specific reference to insurance required by the McCarran-Ferguson Act. E-Sign contains a safe harbor for insurance agents and brokers who enter into electronic contracts.

E-Sign also contains an exception to preemption for situations in which states are market participants, especially under state procurement regulations.

### **Consumer Protection**

E-Sign contains a number of consumer protection clauses not found in UETA. Where law requires that disclosures or notices be provided to a consumer, E-Sign requires that a consumer “affirmatively consent” (and do so by electronic means) to receive these disclosures and notices electronically. E-Sign provides a rigorous set of notices and procedural requirements before allowing electronic disclosure and notices to satisfy the requirements of law. Additionally, any change in the hardware or software required to receive the disclosures or notices kicks off a new round of consents on the part of the consumer. E-Sign does not change any content or timing requirements for any disclosure required by law.

A federal agency may, by regulation, exempt certain records from these requirements if it

finds that the exemption is necessary to eliminate a substantial burden on electronic commerce and that the exemption will not increase material risks to consumers. E-Sign specifically requires that the Securities and Exchange Commission issue a regulation that has the effect of exempting prospectuses from the consenting requirements.

E-Sign requires various federal agencies to study electronic delivery of documents and disclosures to consumers and the benefits to consumers of the requirement that their consent be given electronically. The reports are due by June 30, 2001.

## **Promotion of International Electronic Commerce**

E-Sign requires the Secretary of Commerce to promote acceptance and use of electronic signatures on an international basis. Consistent with the UETA-like principals set out in the main body of E-Sign and adopting principles of the United Nations Commission on International Trade Law (“UNCITRAL”) Model Law on Electronic Commerce, the secretary must remove paper-based barriers to international commerce, permit parties to determine their own authentication technologies and models, permit proof in court of the validity of those authentication models and take a nondiscriminatory approach to electronic signatures from other jurisdictions.

## **Procedural Issues**

UETA addresses a number of procedural matters that E-Sign does not. They include:

- The ways parties may deliver information to each other;
- The ways parties may contractually vary the requirements from those contained in UETA;
- Attribution of an electronic record or electronic signature to a party;
- Which party bears the risk of transmission errors;
- Methods of resolving errors in transactions with electronic agents;

- Use of electronic records as evidence in criminal or civil proceedings; and
- When and where a record is deemed to have been sent and received.

## ***Effect on Government Agencies***

Each law addresses electronic signatures and records as they relate to government operations. E-Sign reaffirms the formats and standards specified by government agencies, but contains a broad prohibition against agencies imposing or reimposing paper requirements. Beyond this, federal or state agencies with rulemaking authority may interpret the primary provisions of E-Sign as they apply to the law under which those agencies make rules. Such rules must be consistent with the primary provisions of E-Sign and, with very narrow exceptions, they must not add requirements, require records in non-electronic formats, impose unreasonable costs on the acceptance and use of electronic records or accord any particular technology greater legal effect than another. E-Sign does not relieve federal regulatory agencies of the duties already imposed by the Government Paperwork Elimination Act and it should not affect the security and authentication requirements under other federal statutes and regulations, such as the Health Insurance Portability and Accountability Act (“HIPAA”). E-Sign allows government agencies to treat electronic signatures and records differently where state or federal procurement law is concerned.

Michigan’s enactment of UETA requires the Michigan Department of Management and Budget (the “DMB”) to determine whether, and the extent to which, state departments will create, generate, send, communicate, receive, accept, store, process, use and rely on electronic records and electronic signatures. The DMB may also specify record and signature formats, types of signatures, control processes and other practices. However, unless otherwise required by subsequent law, UETA does not require a governmental agency or state official to use, or permit the use of, electronic records or signatures.

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## ***Effective Dates***

Most of the provisions of E-Sign became effective on October 1, 2000. Record retention requirements will become effective on March 1, 2001 except where federal or state agencies are in the process of rulemaking on that date, in which cases the effective date will be June 1, 2001.

Certain federal government guarantees, insurance and student loan programs will be covered by E-Sign between now and June 30, 2001.

Both houses of the Michigan legislature voted to give UETA immediate effect, so it became effective immediately and covers "any electronic record or signature...created, generated, sent, communicated, received, or stored" on or after October 16, 2000.

## ***The Road Ahead***

### **Standardizing Electronic Signatures: "Digital Signatures"**

The technology-neutral language of both E-Sign and UETA leaves it to the markets to arrive at their own standards. The early favorite among forms of electronic signature is the so-called "digital signature." A digital signature uses an "asymmetric cryptosystem" to encode messages using encryption systems that most industry experts consider to be exceedingly difficult to break. The actual digital signature is a code that is integrated into a message. The sender runs the message through a computer algorithm called a "hash function" using a long string of numbers that is known only to the sender (called the sender's "private key") and a similar string of numbers that is known to the world (usually through a publicly-accessible server) that is associated with the receiver (the receiver's "public key"). The result of the hash function is the digital signature. The receiver of the message runs the message, including the digital signature, through a similar hash function, this time using the *sender's public key* and the *receiver's private key*. The hash function using these keys will verify the message as genuine only if the message was initially encoded using the sender's private key and if the message has not been altered since the sender encoded it.

Digital signatures are the early leaders because they offer a high degree of security and reliability. Several leading providers of digital certificates and signature systems have already emerged and it appears likely that these providers will move rapidly toward an industry standard.

### **Transmissions are Safer, But Old-Fashioned Misappropriation is Still a Concern**

Encryption technology has addressed most consumer and business concerns about security while data is in transit over the Internet. If there is an increased threat, it arises from the speed of online commerce and not from electronic security issues. A person who misappropriates the electronic signature of another can do more mischief in a shorter time than was possible in the paper world. Parties that use electronic signatures will want to guard them closely, verify them often and have a means in place for cancelling them quickly if they are misappropriated.

### ***Where to Find More Information***

The full text of Michigan's enactment of UETA is available by searching for Sections 450.831 to 450.849 in the Michigan compiled laws at [www.michiganlegislature.org](http://www.michiganlegislature.org). The E-Sign legislation is available by searching for 2000 (106th Congress) Senate Bill 761 at [thomas.loc.gov](http://thomas.loc.gov).

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