

## MEMORANDUM

To: Uniform Electronic Transactions Act Drafting Committee and Observers.

From: Ben Beard, Reporter.

Date: November 25, 1997.

Re: Second Draft of The Uniform Electronic Transactions Act - General Comments and Issues.

Enclosed is the second draft of the Uniform Electronic Transactions Act (the "Act"). This draft has been revised from the August 15, 1997 Draft discussed at the September 19-21, 1997 meeting of the Drafting Committee in Arlington, Va.

The enclosed draft has been marked to show changes from the August 15, 1997 draft. I would be extremely remiss if I did not acknowledge the phenomenal efforts of Peggy Rasmussen, the Faculty Secretary at the University of Idaho College of Law. Because of the significant reorganizations and deletions appearing in this draft, the comparison of these drafts was very difficult and time consuming. Ms. Rasmussen put in a great deal of time and effort to make the enclosed draft appear cogent and easy to read. We have done everything possible to present the changes in the clearest manner possible. To the extent any changes were missed in the marking, it was inadvertent and entirely my responsibility.

### PRINCIPAL ISSUES IN THIS DRAFT.

1. The question of what, if any, heightened protection should be accorded electronic records and signatures where security procedures are applied, occupied much of the discussion at the September meeting. While a number of participants argued that fairly strong presumptions were necessary to promote electronic commerce, others felt that the state of technology and current market was still too underdeveloped to warrant the creation of any presumptions. In addition, the functionality of the additional criteria set forth in former Section 302 for a security procedure creating a secure electronic signature has been questioned and debated in both this Act and elsewhere. This draft adopts a compromise position which also is consistent with Article 2B.

A. First, the definition of security procedure has been revised to track the definition of attribution procedure in Article 2B. The current definition has deleted the catch-all provision appearing in the August draft which permitted any procedure to qualify as a security procedure if shown to be commercially reasonable. This provision was rightly criticized as creating great uncertainty and potential risks for unsuspecting parties. The definition now limits security procedures to those procedures agreed to or adopted by the parties or established by law, which are also commercially reasonable. The purpose of this limitation is to assure that a party will not be bound by security procedures, and the resulting limited presumptions, without its knowledge and consent or the determination of the propriety of a security procedure by a legislative body. The requirement that any security procedure must also be commercially reasonable provides protection to unsophisticated parties who may adopt a procedure in the course of a transaction without full appreciation of the procedure's efficacy.

The revised definition of security procedure together with new Section 110, which sets forth rules for allocating losses in the absence of a commercially reasonable security procedure, is designed to create a situation where a person seeking the benefits of (relying on) electronic commerce bears the lion's share of any risk associated with unsecure electronic records and signatures. A person invoking the use of electronic media in a commercial setting is in the best position to analyze and weigh the risks of conducting business electronically. Accordingly, that person should be put to the task of assuring itself that the procedures it adopts are sufficient to protect its ability to rely on electronic records and signatures which it receives. If such a person determines to enter the electronic market without sufficient protections, it should bear any losses from its decision.

One further benefit of this approach is the fact that the sophistication of the parties becomes less important. If the party entering the electronic marketplace is the less sophisticated party, it will know that it must gain the necessary knowledge and sophistication to determine which procedures to implement to protect its own interest. This draft takes this concept to its logical conclusion by eliminating the distinctions between consumers and merchants, which definitions have been deleted. In

short, this draft requires persons who desire the advantage of electronic commerce to obtain the necessary sophistication to protect their own interests. Where a person may seek to take advantage of the unsophistication of a relying party, new Section 111 imposes an obligation of good faith as a curb on such possible advantage taking.

B. Second, while the draft does create limited, "bursting bubble," rebuttable presumptions (See Section 102(17)), it does so in the specific context of the application of security procedures to electronic records (Sections 202 and 203) and electronic signatures (Section 302). The substantive law relating to commercial transactions is left largely unchanged by this Act. A given rule of law may require a "signed writing" in which case the provisions of Section 202, 203 and 302 may all be applicable to determine whether a presumption will attach in attributing, and assuring the informational integrity of, an electronic record, and determining whether the electronic record was signed. It may also be the case that in a particular transaction the only issue is whether a given electronic record (such as a required notice) originated with (is attributable to) the sender of the notice. In such a case, reference would need be made only to Section 202. If the informational integrity of the notice was also at issue (e.g., because the recipient took some required action in reliance on the content of the notice), Section 203 would be applicable. In each case, the efficacy of the security procedure would be tested based on the purpose for which the electronic record or signature was required.

C. The grouping of provisions related to electronic records in Part 2 and electronic signatures in Part 3 is intended to focus consideration on each of these aspects of electronic commerce. The previous organization created a focus on "secure" electronic records and signatures. The principal purpose of this Act is to remove legal barriers to the effectuation of records and signatures in an electronic medium. The focus therefore should be on the validating provisions of each, with a secondary focus on the circumstances under which the Act will provide heightened protection for electronic records and signatures when security procedures are used.

2. SCOPE OF THE ACT. The scope of this Act remains one of the most difficult areas to be resolved by the Drafting Committee. In this regard I have made some revisions which I hope will advance resolution of this issue.

A. Definitions. Definitions for "commercial transaction" and "governmental transaction" have been placed in the text in section 102. These definitions also remain as part of the commentary to section 103 on Scope.

B. Commercial Transactions. The limitation of the Act to commercial transactions (and governmental transactions based on the expansion last summer) eliminates many of the areas of concern in the discussion of the exclusions from the Act at the September meeting. For example, wills and trusts will only in the most unusual of circumstances arise in the context of a commercial transaction.

Subsection (a) of section 104 precludes application of the Act to the extent its application would be contrary to the manifest intent of, or repugnant to, a rule of law which requires a pen and ink writing or signature. This "repugnancy" provision has been added as a result of many comments at the September meeting and tracks similar provisions in the Illinois and Massachusetts draft legislation.

Subsection (b) of section 104 provides that the Act is subject to consumer protection laws and the UCC. Subsection (c) directs that the Act and any such rule be construed as consistent, but provides that the other rules apply if consistent construction is not reasonable. The commentary will expand on the idea that there would appear to be nothing inherently unreasonable in allowing consumer protections and disclosures to be accomplished electronically so long as the purposes of the consumer protections are substantially satisfied. Of course, every effort will be made to make the Act consistent with UCC provisions. One area for discussion in this regard relates to the interaction of Article 3 and 4 with the provisions on transferable records in Section 405.

The issue which remains relates to other areas which should be excluded or to which the Act should be subject. In considering other areas for exclusion, the inherent limitation to commercial transactions must be kept in mind.

C. Governmental Transactions. The Scope of the Act is now clearly made subject to Part 5. Section 501 has been revised only minimally. It does now include an exhortation to any rulemaking agency to consider and coordinate with other governmental entities to avoid conflicting regulation.

Exclusions such as appeared in former Section 105 relating to the *conveyancing* of real property, would be subsumed in the provision that the Act is subject to Part 5. Unless the state agency accepting real estate (or any other) filings, implements electronic filing, the Act would not apply to this aspect of a transaction.

At the September meeting, a number of observers were concerned that the Act did not adequately address the needs of commerce in removing barriers to electronic media which exist when dealing with governmental entities. A workable solution to such concerns seems limited by the reality that legislatures will not be enthused about adopting broad mandatory legislation which entails significant resource outlays in a time of claimed resource (i.e. tax) limits. The reporter requests advice and instruction regarding whether any provision can be realistically proposed as part of this Act which does more than exhort state agencies to go electronic, and if they do so to do so in a manner which takes account of potential conflicting technological requirements. To actually *require* state agencies to adopt electronic means of transacting its business, whether intragovernmentally or with private persons, seems to beg for non-uniform adoption at worst, and adoption without a proposed Part 5 at best.

3. AGREEMENT AND MANIFESTATION OF ASSENT. The concepts of manifestation of assent and opportunity to review have been retained. They now appear as substantive sections in Part 1. While the definition of agreement no longer expressly includes manifestation of assent and now reflects the definition set forth in the UCC, the concept remains important in determining the terms of any agreement (See Section 401). One question is whether the concept is properly applied in section 302(b)(1) as the equivalent of a signature? Should not a person be deemed to have signed an order for goods or services over the internet even if no actual "signature" is attached to the transmission? By pointing and clicking on various terms and icons in order to obtain the goods or services, does not a person manifest the requisite intention to identify him/herself, adopt the terms clicked and agree to be bound by her/his actions?

On a related point, Section 203 on Detection of Errors has new provisions adapted from Article 2B to address the "single keystroke error" concern raised at the September meeting. Your comments on the propriety of the concept and workability of the provisions will be most welcome.

Such are the main issues I see for resolution in this draft. I fully trust that others will be raised which I have not foreseen. I look forward to our meeting in Dallas January 9-11, 1998, and to moving closer to resolution of all issues raised by this project.

I wish you all a safe, healthy and happy holidays, and look forward to seeing you all in Dallas.

A NOTE ABOUT THE SOURCES REFERENCED IN THIS DRAFT.

Unless otherwise noted, references in this draft are to the following sources:

1. "Article 2B Draft" - Draft Uniform Commercial Code Article 2B - Licenses, November 1 1997.
2. "Illinois Model" - Illinois Electronic Commerce Security Act, September 2, 1997 Draft.
3. "Uncitral Model" - United Nations Model Law on Electronic Commerce, approved by the UN General Assembly November, 1996.
4. "Oklahoma Model" - Oklahoma Bankers Association Technology Committee, Digital Writing and Signature Statute, Second Discussion Draft, June 17, 1996.
5. "Massachusetts Model" - Massachusetts Electronic Records and Signatures Act, DRAFT - November 4, 1997.
5. "UCC Section" - Uniform Commercial Code, Official Text, 1990.
6. "Article 1 Draft" - Uniform Commercial Code Revised Article 1 - General Provisions (199\_), September 1997 Draft.