MEMORANDUM

To: Electronic Transactions Act Drafting Committee and Observers.

From: Ben Beard, Reporter.

Date: August 15, 1997.

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

Enclosed is the first draft of the Uniform Electronic Transactions Act (the "Act"). This draft was prepared based on the model provisions distributed in April and discussed at the May 2-3, 1997 meeting of the Drafting Committee in Dallas.

GENERAL BACKGROUND AND OUTLINE.

On July 1, 1997, President Clinton announced the Administration's "Framework for Global Electronic Commerce." The Framework indicates that global commerce via Internet transactions is anticipated to reach "tens of billions of dollars by the turn of the century." That estimate does not include electronic commerce being conducted today over so-called "closed systems" such as electronic data interchange. Clearly the magnitude of the economic activity being conducted electronically is huge, and growing rapidly. This activity is currently being conducted amid legal uncertainty regarding the validity and efficacy of the electronic records and documents being used to evidence the commercial transactions and relationships being created. Recognizing this void, the Framework calls for the creation of a "'Uniform Commercial Code' for Electronic Commerce."

This draft has been prepared to address that uncertainty and fill the legal void by creating a basic legal structure recognizing and effectuating records and signatures generated electronically. The fundamental policy running throughout this Act is to establish the legal equivalence of electronic records and signatures with paper writings and manually signed signatures. At its most basic, this policy focuses on overcoming perceived bias against electronic records and signatures because of their ethereal nature and lack of concrete substance. The concern in this regard relates to the sense that something as seemingly fleeting as electronic "beeps and chirps" is insufficient to support and evidence commercial activities involving potentially large sums of money.

Whether the concern manifests itself in the context of existing writing and signature requirements such as the Statute of Frauds, or evidentiary requirements to prove the existence and terms of a transaction, the concerns are real for many. Notwithstanding these concerns, however, the economic benefits of

electronic commercial activity, e.g. time, efficiency and storage savings, have caused many commercial actors to proceed with implementing electronic commerce in the face of these concerns. This is largely due to the recognition among commercial actors that electronic commerce is generally as reliable and safe as paper, and justifies the risks inherent in the legal uncertainty.

The legal uncertainties surrounding electronic commerce relate principally to the media in which these transactions are conducted, i.e., electronic records as opposed to paper and ink writings. For most commercial activity, once electronic media are recognized, the substantive body of commercial law, whether derived from statutes such as the Uniform Commercial Code or the common law as reflected in Restatement (Second) Contracts, provides the applicable and appropriate rule of law. This Act proceeds in Part 2 to address the need of assuring the recognition and utility of electronic records and signatures. This is carried one step further in Part 3 which creates presumptions regarding the indentity and integrity of electronic records and signatures where heightened security procedures are used. In part 4, the Act addresses specific substantive rules which need adjustment because of the nature of electronic communications.

The benefits of electronic transactions have also been recognized by governmental entities. In recognition of the desire of governmental entities to achieve these benefits, the Scope and Program Committee expanded the scope of this act to cover governmental transactions. Accordingly, Part 5 authorizes state agencies to use electronic records in intra-governmental and external governmental transactions, subject to further regulation by the state.

Part 2 reflects the fundamental premise of this Act that electronic media should be treated as the equal of written media. Accordingly, sections 201-203 state that electronic records and signatures may not be denied legal effect solely on the ground that they are electronic and not written. What this means in operation is that the integrity and validity of any electronic record or signature, like its written counterpart, must be considered in light of all surrounding circumstances. Sections 204-207 set forth requirements for establishing the legal equivalence of the electronic record or signature. Without specifying any particular technology, these sections recognize that, like written records and signatures, methods exist and proof is available to demonstrate the validity and integrity of electronic records. Similarly, Part 3 operates on the premise that security procedures exist which, if shown, justify the creation of presumptions of validity and integrity.

Part 4 addresses discrete rules regarding contract formation and performance where electronic records and signatures are used. Section 401 reiterates the equivalency of media, whether paper or electronic. The provisions of section 402 deal principally with the phenomenon of computer actions taken without human intervention in the formation or performance of a transaction. Section 403 allocates loss and responsibility regarding terms in circumstances where security procedures are involved. It has been left in Part 4 of this draft since it deals with discreet aspects of contract formation and construction. However, since this section deals with circumstances under which a party will be bound by (attributable for) an electronic record, and when a party will bear the consequence of transmission errors (content integrity), this section may serve as an alternative to the presumptions set forth in Part 3. Section 404 reverses the contract mailbox rule, and provides that electronic records are effective when received. This is consistent with the essentially instantaneous nature of electronic communications and the possibility of contractually requiring acknowledgement of receipt (Section 405).

ISSUES IN THIS DRAFT.

The following is a non-exclusive listing of issues presented in this draft:

1. SCOPE. Scope remains an issue for the Drafting Committee.

A. PRIVATE TRANSACTIONS. At the May meeting, members of the Committee were wary of expanding the scope beyond contractual transactions. In particular there was strong opposition to a broad "all writings and signatures" coverage, along the lines of the Massachusetts and Illinois Models. The phenomenal coverage of such an act, coupled with the requisite search and replace burden, prompted a view that such an approach would generate significant opposition among members of the bar and in legislatures, and seriously jeopardize the enactability of the Act.

On the other hand, many observers believed that limiting the scope of the Act to purely contractual transactions would impair the usefulness of the statute and create potential ambiguity as to the applicability of the Act to certain records. On example given related to electronically maintained medical records relevant to litigation over coverage under an insurance contract.

This draft takes an intermediate approach adopted from the Uncitral Model Law. Section 104 applies the Act to "records generated, stored, processed, communicated, or used for any

purpose in any commercial ... transaction." The scope of a commercial transaction is set out in the Reporter's Note by reference to the footnote to the Uncitral Model Law establishing a very broad interpretation of commercial. The Act then provides, in section 105, for exceptions to the applicability of the Act for transactions which should be clearly excluded. Finally, in certain general provisions establishing the efficacy of electronic records and signatures there are specific placeholders provided for further exceptions.

While coverage of all writings and signatures does pose real problems in identifying those areas of current law (numbering in the tens of thousands) imposing writing/signature requirements, the limitation to documents of a purely contractual nature does pose the problem of lack of coverage of relevant documents. By expanding coverage to commercial transactions, the Act permits inclusion of documents and records which may properly be maintained in electronic form consistent with the expectations of commercial parties. However, the question remains as to appropriate carve-outs from the Act.

B. GOVERNMENTAL TRANSACTIONS. This draft addresses the expansion of the Scope of the project approved by the Scope and Program Committee this summer. Section 501 authorizes state agencies to implement and regulate the use of electronic records and signatures in intra-governmental transactions and governmental transactions with private parties. The section only authorizes this action, specifically reserving to state agencies the right to refuce to go electronic, and the authority to regulate which electronic records and signatures will be acceptable.

2. APPLICABLE LAW. The Act adopts the position that the parties are free to choose the law applicable to their contract. This broad freedom is circumscribed in three contexts: 1) consumer transactions; 2) where the chosen law is contrary to a fundamental public policy of the jurisdiction whose law would otherwise apply; and 3) in international transactions where the chosen law bears no reasonable relation to the transaction.

In the absence of agreement as to applicable law the Draft provides two alternatives for the Committee's consideration. First, the applicable law is the law of the forum state. This so-called "imperial clause" is drawn from UCC Section 1-105(1) and is intended to prompt the adoption of this Act to promote uniformity. The second alternative is drawn from the April, 1997 Draft of Revised Article 1, and calls for the application of that law which would otherwise be selected under the forum's choice of law rules.

3. CHOICE OF FORUM. This section has been taken from Article 2B. It addresses the concern raised at the May meeting that, in the electronic environment, a supplier of goods or services may set up a web page over which it has no control regarding where the page will be accessed. The concern relates to the possibility of a vendor being subject to jurisdiction in a forum where it had no contemplation of ever being subject. The example given related to the liability of a Missouri vendor for failure to comply with California disclosure requirements as part of its web page, which was accessed in California. While the issues of jurisdiction in the context of state criminal or administrative enforcement is beyond the scope of this Act, the concern is real that a private party may attempt to litigate that failure in California when the only action taken by the vendor was the posting of the web page. If the vendor actually makes a sale in California, minimum contacts may be sufficient to satisfy personal jurisdiction in California.

The provision in section 108 is intended to permit parties to establish an exclusive forum for litigation of disputes arising from the commercial transaction in order to alleviate this uncertainty.

4. ELECTRONIC SIGNATURES - PROOF. Section 204 is new and is drawn largely from Article 2B-114. In response to comments made at the May meeting, the definition of authenticate has been reduced to its essence. That is, the definition reflects those attributes of a symbol adopted with intent to authenticate, presumed to apply in the case of a written signature on paper. This streamlined version of authenticate is then coupled with the existing definition of signature and the new definition of electronic signature to establish the requisite intention necessary when one has signed or electronically signed a record. Section 204(a) simply states the presumed effect of an electronic signature.

Subsection (d) is new and drawn from UCC Section 3-308. It establishes a procedural hurdle to denying the effect of an electronic signature. However, if the signature is specifically denied in the pleadings, the proponent of the validity of the signature has the burden to establish the validity of the electronic signature. In meeting this burden, the next question relates to whether the Act will establish presumptions in aid of that proof if security procedures or other indicia of reliability are present (Part 3).

5. LEGAL EFFECT OF SECURITY PROCEDURES. Part 3 has been retained from the models presented at the May meeting. That Part provides general rules for the creation of secure electronic

records and signatures, and more importantly perhaps, creates presumptions regarding the validity of secure electronic records and signatures. As explained in the Reporter's Notes, the determination of whether to create a presumption rests largely with this Committee as a question of policy. Certain security procedures (e.g., public key infrastructure) exist which are so "robust," that presumptions of their efficacy and validity may be warranted. However, participants at the May meeting raised concerns that as a result of the technology neutrality of the Act, there was insufficient certainty as to which security procedures were sufficiently "robust" to qualify an electronic record or signature as secure. In the face of this uncertainty some participants expressed the view that presumptions were inappropriate.

Presumptions may be inappropriate for a more fundamental reason. If the premise of the Act is to establish the legal equivalence of written records/signatures and electronic records/signatures, the question may be asked why the Act creates special treatment for secure electronic records/signatures. As a general proposition the proof of a written record or signature is not aided by any presumption of validity. Although procedural benefits such as appear in UCC Section 3-308 (and reflected in Section 203(d) of this Act) exist, these procedural benefits do not present the same hurdles to a party seeking to show the invalidity of a signature as would a presumption of the validity.

Section 403 provides a different approach to the issue of the use of security procedures. By setting forth default rules regarding attribution and liability for transmission errors based on the conduct of parties in using or maintaining security procedures, this section focuses on the use or misuse of agreed procedures. It places control for the effect of an electronic record/signature on the parties, rather than creating a legal presumption based solely on the use of a security procedure. It also requires a party which has required use of a commercially unreasonable security procedure to justify its actions in imposing the security procedure or bear any loss resulting from the use of that procedure.

6. GOVERNMENTAL TRANSACTIONS. Section 501 addresses the expanded scope of the Act. It covers both intra-governmental use of electronic records/signatures and government-private party use. It provides authorization to state agencies to use electronic means while preserving a state agency's ability to opt-out of the Act.

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, July 25-August 1, 1997, presented at the Annual Meeting of the National Conference.

2. "Illinois Model" - Illinois Electronic Commerce Security Act, June 4, 1997 Interim Draft.

3. "Uncitral Model" - United Nations Model Law on Electronic Commerce, approved by the UN Gneral Assembly November, 1996.

4. "Oklahoma Model" - Oklahoma Bankers Association Technology Committee, Digital Writing and Signature Statute, Second Discussion Draft, June 17, 1996.

5. "UCC Section" - Uniform Commercial Code, Official Text, 1990.

6. "Article 1 Draft" - Uniform Commercial Code Revise Article 1 - General Provisions (199_), April 1997 Draft.