The E-Signature Act

A Promising Development for Insurers

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Economic growth has escalated dramatically over recent years, fueled largely by the increase in e-commerce – business transactions that take place over the Internet. E-commerce is expected to continue its upward surge, reaching $1.6 trillion by 2003, up from $500 billion in 1999. It is estimated that online consumer spending alone (i.e., not counting business-to-business transactions) will total $185 billion by 2003. Passage of the E-Signature Act will help assure that this growth occurs.

Last year, President Clinton signed into law the Electronic Signature in Global and National Commerce Act (hereinafter the "E-Signature Act" or the "Act"), which removed one obstacle to the continued growth of e-commerce. While it was possible to complete many types of transactions online, many other transactions required an ink-and-pen signature for validity. The Act removed this impediment for most types of consumer and business transactions. The Act prevents parties from challenging the validity of a transaction solely on the basis it was not signed by hand. The Act also provides for the retention of contracts and records in electronic form. President Clinton signed the bill with a "smart card," making this the first bill to be signed into law with an e-signature.

The E-Signature Act is particularly important to the insurance industry because it creates a greater degree of uniformity among the states. While it does provide for exceptions to preemption, it nevertheless assures that electronic signature legislation throughout the nation will be similar in its basic components, thus assuring that electronic transactions will be more uniformly validated and enforced.

Although the E-Signature Act will not necessarily increase insurance business – since the demand for insurance is relatively inelastic – the Act nevertheless allows insurance companies to service clients who prefer to transact business via the Internet and e-mail. Now, all transactions involved in the purchasing of insurance to the submitting of a claim can be completed online. With the insured's consent, all notices, including premium notices, change of benefit notices, cancellation notices (with the exception of health and life insurance), and denials of claims may be sent electronically. Eventually, the need for huge warehouses stuffed with mountains of paperwork will no longer exist as they are replaced by computer servers that can store great amounts of information in much less space. These capabilities should result in large cost savings for the insurance industry.

The Electronic Signature in Global and National Commerce Act

The authors of the E-Signature Act (S. 761) originally envisioned a simple piece of legislation designed to allow electronic signatures in the online world to carry the same legal weight as a "John Hancock" in the offline world. *See* 146 Cong. Rec. S5215 (daily ed. June 15, 2000). But during the legislative process, the financial services and insurance industries suggested expanding the scope of the statute to encompass electronic record-keeping as well, allowing increased efficiency and tremendous cost savings. *See id.* At the same time, the bill received criticism from consumer groups fearing that the Act would promote fraud and deceit by the unscrupulous, who would send important notices by e-mail that consumers could not access or read. *See id* at S5216. The bill was enlarged to take account of both interests. Moreover, the final version of the Act has broad application.

The general provision of the Act provides that, with respect to a transaction in interstate or foreign commerce, "(1) a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and (2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation." 15 U.S.C. §7001(a). The term "electronic signature" is defined 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." 15 U.S.C. §7006(5). The Act also provides for the electronic notarization of electronic records. See 15 U.S.C. §7001(g).

The term "electronic record" is defined as "a contract or other record created, generated, sent, communicated, received, or stored by electronic means." 15 U.S.C. §7006 (4). The Act does not prescribe any particular technology, but leaves that matter to the agreement of the parties, who are then free to select a technology with security commensurate with the importance of the transaction.

The Act appears to have wide application. The word "transaction" is defined as "an action or set of actions relating to the conduct of business, consumer, or commercial affairs between two or more persons." 15 U.S.C. §7006(13). Any business or commercial transaction seems to qualify. The Act expressly applies to the business of insurance and the Act provides certain protections for insurance agents and brokers. *See* 15 U.S.C. §7001(i) & (j). Specifically, an "insurance agent or broker acting under the direction of a party that enters into a contract by means of an electronic record or electronic signature may not be held liable for any deficiency in the electronic procedures agreed to by the parties if – (1) the agent or broker has not engaged in negligent, reckless, or intentional tortious conduct; (2) the agent or broker was not involved in the development or establishment of such electronic procedures; and (3) the agent or broker did not deviate from such procedures." 15 U.S.C. §7001(j).

By its terms, the Act does not apply to the cancellation or termination of health insurance or benefits or life insurance benefits. *See* 15 U.S.C. §7003(b)(2)(C). In addition, the Act does not apply to certain aspects of wills, family law, the Uniform Commercial Code, official court documents, utility services, foreclosure or eviction, product recalls, or the transportation or handling of hazardous materials. *See* 15 U.S.C. §7003(a) & (b). As it relates to these exceptions, the E-Signature

Act would neither validate nor bar the use of electronic records or signatures; it simply does not apply and state law would govern the determination of the effectiveness of the electronic records and signatures.

The word "solely" in the general provision is intended to ensure that an electronic contract, notice or disclosure gains no additional validity or sanctity against challenge just because it is in electronic form. *See* 146 Cong. Rec. S5229 (daily ed. June 15, 2000). Thus, if a consumer were deceived or unfairly convinced in some way to enter into a contract electronically, state and federal unfair and deceptive practice laws would still apply. In other words, compliance with the Act does not abolish the need for the transaction and parties to the transaction to comply with other applicable statutes, regulations, or rules of law.

In the same vein, the Act does not affect any requirement imposed by a statute, regulation, or rule of law, other than a requirement that contracts or other records be written, signed, or in non-electronic form. *See* 15 U.S.C. §7001(b)(1). Thus, if a statute requires a notice to be sent within a certain time period, the Act would have no effect on that time requirement. For example, section 662 of the California Insurance Code requires a notice of cancellation to be sent 20 days before it becomes effective. The Act will have no effect on that requirement; however, it would allow the notice to be sent electronically if both parties consent. Further, the Act is not compulsory. It does not require anyone to agree to use or accept e-signatures. *See* 15 U.S.C. §7001(b)(2).

In response to the initial criticism from consumer groups, the final version of the Act contains fairly detailed consumer protection provisions. If a statute, regulation, or other rule of law requires that information relating to a transaction be provided or made available to a consumer in writing, the requirement will only be met through the use of electronic records if the consumer consents to their use and has not withdrawn that consent. *See* 15 U.S.C. §7001(c)(1)(A). Before consenting, the consumer must be provided with: (1) a clear and conspicuous statement informing him or her, among other things, of the right to have the information on paper and of the right to withdraw consent to electronic mail, including the procedures for withdrawing consent and any consequences flowing therefrom, *see* 15 U.S.C. §7001(c)(1)(B); and (2) a statement of the hardware and software requirements for access to and retention of electronic records, *see* 15 U.S.C. §7001(c)(1)(C)(i).

Moreover, to assure the consumer will actually be able to receive and access electronic records, the consumer must consent electronically "in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent." 15 U.S.C. §7001(c)(1)(C)(ii). According to Senator Ron Wyden, a member of the conference committee that drafted the final version of S. 761, the "reasonable demonstration" requirement is met if the consumer, in response to an electronic vendor inquiry, actually opens an attached document sent electronically by the vendor and confirms the ability to read the document in an e-mail response. *See* 146 Cong. Rec. S5216 (daily ed. June 15, 2000). It is *not* sufficient for the vendor to tell the consumer what type of computer or software he or she needs. *See id.* Nor is it sufficient for the consumer merely to tell the vendor in an e-mail that he or she can access the information in the specified formats without actually demonstrating the ability to do so. *See id.*

A violation of the consumer consent provisions will not, however, in and of itself, invalidate an electronic contract. See 15 U.S.C. §7001(c)(3). Presumably, existing substantive contract law would apply. The pivotal determination would be whether the violation of the consent provisions resulted in the consumer failing to receive information necessary to the enforcement of the contract. For example, if the consumer was able to view the terms of the contract before signing it, but the manner in which the consumer consented did not "reasonably demonstrate" that he or she could access the electronic form of the information at a later date, the contract could still be valid and enforceable despite the technical violation of the electronic consent provision. *See* 146 Cong. Rec. H4352 (daily ed. June 14, 2000). However, any notices sent electronically after the contract is entered into might be deemed not to have been provided to the consumer absent additional evidence to the contrary.

The Act also contains certain provisions for the retention of records. If state law requires a contract or other record to be retained, that requirement will be met by the retention of an electronic record which accurately reflects the information in the contract or other record, and which remains accessible to all persons who are entitled by law to have access. *See* 15 U.S.C. §7001(d)(1)(A) & (B), The contract or other record must remain accessible for so long as retention is

required, see 15 U.S.C. §7001(d)(1)(B), and must be in a form that is capable of being accurately reproduced for later reference, whether by transmission, printing, or otherwise see 15 U.S.C. §7001(d)(1)(B). This retention provision allows regulatory agencies and law enforcement to ensure compliance with the law. For example, a government agency can ensure compliance with financial requirements imposed upon participants in government programs by having records retained in an electronic form that can be easily accessed by government auditors. *See* 146 Cong. Rec. S5230 (daily ed. June 15, 2000). Similarly, bank and other financial regulators can ensure the safety and soundness of the institutions they regulate and their compliance with all relevant regulatory requirements if records are retained electronically in an accessible format. *See* id.

An electronic contract or record may not be enforceable if state law requires it to be retained in writing and it cannot be reproduced for later reference by those who are entitled to retain it. *See* 15 U.S.C. §7001(e). This section is intended to make electronic records equivalent to their written counterparts in two respects. First, the electronic record must be capable of being retained, like a contract can be filed away. Second, the electronic record must be capable of being reproduced, like a contract can be photocopied. See 146 Cong. Rec. S5284 (daily ed. June 15, 2000). Thus, a requirement that a contract be in writing will not be met by flashing an electronic version of the contract on a computer screen. See *id.; id.* at S5220. Similarly, product warranties must be provided to purchasers in a form that they can retain and use to enforce their rights in the event that the product fails. *See id.* at S5220.

Finally, the Act provides for state laws to modify, limit, or supersede the foregoing provisions only if the state law constitutes an enactment or adoption of the Uniform Electronic Transactions Act (UETA).[1] However, if the state chooses to except certain transactions under section 3(b)(4) of the UETA (allowing for additional exceptions), these exceptions will be preempted by E-Signature to the extent they are inconsistent with the Act or accord greater legal status or effect to a particular technology. *See* U.S.C. §7002(a).[2]

Implications

Some insurance companies may incur an initial expense for software to meet the consumer consent requirements and for the electronic maintenance of records. That expense should be offset by the increase in efficiency and decrease in postal and storage costs.

The use of electronic records for business, consumer, and commercial transactions should not have much impact on the substantive law of contracts. The same challenges to formation, performance, authority, agency, and authenticity are likely to be made. Intent will still be an issue because the definition of "electronic signature" includes the requirement that the party intended to sign the record. Similarly, issues inherent in insurance law will still arise, such as whether an insured is presumed to have read the policy, whether exclusions are set out in clear and conspicuous language, whether an insured brought suit within the applicable time period, etc. However, we should expect litigation and new law relating to the procedures required for consumer consent, the effect of failing to use an agreed security procedure, the effect of failing to retain a record in an accessible form, and the impact of mistakes made by an individual while dealing with an electronic agent as these are issues that no court has yet explored. ▼

Footnotes:

[1]The UETA, as approved by the National Conference of Commissioners on Uniform State Laws in 1999, is a model act concerning electronic signatures and records for adoption by individual states. It differs from the E-Signature Act in many ways, but, as the UETA served as a basis for the E-Signature Act, there are many similarities as well. A detailed discussion of the UETA is beyond the scope of this article, but may be found in Shea C. Meehan, *Consumer Protection Law and the Uniform Electronic Transactions Act (UETA): Why States Should Adopt UETA as Drafted,* 36 Idaho L. Rev. 563 (2000).

[2]The Act also addresses: (1) an exception to preemption where the state is acting as a market participant, *see* § 7002(b); (2) application of the Act to federal and state governments, *see* § 7004; studies to be conducted, *see* § 7005; transferable records (written notes governed by Article 3 of the UCC), *see* § 7021; and promotion of the use of electronic signatures nationally and internationally, *see* § 7031.