

Intellectual Property & Technology Law Journal

VOLUME 19 • NUMBER 5 • MAY 2007

Common Misconceptions Surround Electronic Transactions with Consumers

By Ethna M.S. Piazza

In the six years since the Federal Electronic Signatures in Global and National Commerce Act (E-Sign) took effect,¹ online retail sales have flourished.² Many non-retail businesses would like to “go fully electronic,” but technology limitations, unfamiliarity with E-Sign’s requirements and fear that they may make a wrong choice in e-implementation may still be holding them back. E-Sign was designed to eliminate legal impediments to use of electronic signatures and electronic records in consumer transactions. Yet, several misconceptions exist at some companies about E-Sign’s requirements.

Consumer Disclosure and Consent

Two common misconceptions relate to the consumer disclosure requirements in E-Sign. E-Sign’s requirements for electronic delivery of consumer protection disclosures have been lauded by consumer advocates as necessary to protect consumers who “are not ready to use” electronic consumer disclosures. Some industry representatives, however, have criticized the requirements as problematic, burdensome, confusing, and a cause of frustration to their valued customers or potential customers because of the extra steps involved. Wachovia Corporation was one of several companies that reported this to the Department of Commerce (DOC) and the Federal Trade Commission (FTC) in 2001 when the agencies prepared their joint report to Congress (mandated by § 105(b) of the E-Sign) (Report), on the impact of the consumer consent provision of 5 101(c)(1)(C)(11). The FTC and DOC felt that the online disclosure procedures enhance consumer confidence and discourage deception and fraud “by those who might fall to provide consumers with information the law requires that they receive.”³

Ethna M.S. Piazza is a partner in the Corporate and Securities and Intellectual Property Practice Groups of Sheppard, Mullin, Richter & Hampton, LLP in its San Diego office. She can be reached at epiazza@sheppardmullin.com.

Several participants in the agencies’ information gathering effort said that it was just too soon after passage of E-Sign to determine whether the consumer consent provision works or whether it needs to be changed. The agencies agreed and recommended that Congress not make any changes to the consumer consent provision.

While in the several intervening years bank regulators have issued guidance on how to comply with consumer consent provisions, many companies in other industries are still wondering how to comply with the consumer consent provisions of E-Sign.

Two common misconceptions surround the consumer notice and consent provisions of § 101(c) of E-Sign: When are they required and how does a company comply? The requirements for consumer disclosure and consent or electronic signature or retention requirements can sometimes confuse uneducated businesses and cause them to shy away from electronic transactions or cause them to dive in headfirst without fully contemplating the potential results or without putting required procedures in place that they mistakenly think do not apply to them.

One misconception is that E-Sign requires a party to make online disclosures described in § 101(c) of E-Sign and obtain a consumer’s consent to those disclosures before the consumer can enter into any transaction using an electronic signature. Section 101(c) requires certain online disclosures be provided and approved by the consumer (1) if the electronic transaction (in interstate or foreign commerce) is of a type that another statute, regulation, or law, separate and apart from E-Sign, requires a particular disclosure or other information about the transaction be provided to the consumer in writing and (2) if the company wants to deliver that written disclosure or information electronically in connection with the underlying transaction. An example would be if a bank wants to electronically deliver to a consumer any disclosures required by the Truth-in-Lending Act and its implementing regulations.⁴

Another misconception is § 101(c) of E-Sign disclosures can be combined in a single step with the delivery of the disclosures required by the other consumer protection law. E-Sign actually imposes additional layers of disclosure and consent before the electronic delivery of the disclosure or other information required by the other consumer protection law. The steps are as follows:

- Step 1: Provide a clear and conspicuous notice informing the consumer of:

1. Any right or option to receive the disclosure or information on paper;
2. The consumer's right to withdraw consent and the procedures to follow in order to withdraw consent;
3. The conditions, consequences, and fees of withdrawing such consent;
4. Whether the consent will apply only to the particular transaction then giving rise to the consumer disclosure requirement, or whether it will apply to identified categories of other records that may be made available during the course of the relationship;
5. The procedures the consumer must use to update the consumer's electronic contact information;
6. How, after consent, the consumer can obtain a paper copy of the electronic record and whether a fee will be charged for the copy; and
7. The hardware and software requirements to access and retain the electronic records.⁵

A company should be careful to not be too restrictive in defining hardware requirements, while of course remaining factually correct. For instance, E-Sign consumer disclosure requirements do not mandate that the consumer have access to a printer but that the consumer have access to software or hardware needed to access or retain an electronic record. Many technologies are now used to retain an electronic record other than printing a paper copy. A few examples are thumb drives, CDs, DVDs, and iPods. Mention of printing is not necessarily a bad idea. But a company should also mention other hardware and software that provide other alternatives.

- Step 2: The consumer must either consent electronically or electronically confirm a previously delivered consent in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information.⁶

Information can be delivered to a consumer via various methods, such as a secure Web site, in the body of an email, or in an attachment to an email. What must be demonstrated is the consumer's ability to access the exact delivery method the company will use. Some best practices are developing in this area. For example, if the company plans to use a .pdf attachment to deliver the other law's consumer disclosure, the consumer must demonstrate an ability to access .pdf documents. In such a case, before the consumer consents as part of this Step 2, the company would send an email to the consumer with a .pdf attachment that contains information necessary for the consumer to complete the consent process. Likewise, if the company plans to deliver the notice in the body of an HTML email, the company would as part of this Step 2 send an HTML email to the consumer that contains information necessary for the consumer to complete the consent process. After the consumer provides that information, demonstrating ability to access the information, then the consumer would be allowed to complete the consent process.

- Step 3: The company would now provide the disclosure or other information required by a separate consumer protection law in a manner that the consumer reasonably demonstrated in Step 2 that the consumer would be able to access in electronic form.

- Step 4: Complete the underlying transaction with the consumer.

- Step 5: If the e-disclosure in Step 1 states that the consent will apply to future transactions with the consumer, then a subsequent notice will be required if a change in the hardware or software requirements needed to access or retain electronic records creates a material risk that the consumer will not be able to access or retain a subsequent electronic record. At that time, the company must provide the consumer with a statement of the revised hardware or software requirements and the right to withdraw consent without the imposition of any fees for such withdrawal and without the imposition of a condition or consequence that was not disclosed in the original e-disclosure given in Step 1. Because of the latter requirement, before a company implements e-disclosure procedures that will relate to future transactions, it must consider what will be the impact of future technology developments and what consequences the company anticipates it may want to impose upon consumers that withdraw consent in the future.

Notably, § 101 (c) (3) provides that failure to follow these procedures will not invalidate the underlying transaction under E-Sign. But, such action could expose the company to liability under the other consumer law for failing to deliver the required consumer disclosure or other information in writing, or that other consumer law could provide that the underlying transaction is invalid, unenforceable, or voidable due to failure to provide the required disclosures in writing.

Consumer advocates assert that these disclosure and consent requirements of E-Sign help ensure that “consumers know that they are consenting to receive future information electronically, and that those who do consent receive it in a manner and form in which they can use it,” as stated by The Consumer Union in its comments submitted to the FTC and DOC in connection with their Report.

Recommendations Related to Consumer Disclosure and Consent

Any company seeking to form contracts with consumers electronically must first determine whether any law or regulation imposes a requirement for providing any disclosures or other information in writing in connection with that transaction. If there is such a requirement, then if the company must evaluate whether it can, and wants to, implement the E-Sign Prerequisites to delivering the disclosure or other information electronically. It must also consider what if any consequences will apply if in the future a consumer withdraws consent to electronic disclosures as a result of changes in hardware or software requirements, whether due to technological developments or the company’s migration to a different system.

Adequacy of the Electronic Record

Some companies do not understand the Impact of failing to keep a complete record of the electronic transaction once it has been completed. If the electronic record is not in a form that is capable of being retained and accurately reproduced for later reference, it may affect its enforceability. There are two separate issues to consider regarding the adequacy of the electronic record.

“Writing” Requirements

If a company seeks to use an electronic contract or electronic record to satisfy a legal requirement that the contract or record be in “writing,” § 101(e) of E-Sign provides that the legal effect, validity, or enforceability of an electronic contract or record may be denied if it is not in a form capable of being accurately reproduced for later reference by all parties who are entitled to retain the contract or record. An example of such a law would be a statute of frauds that requires certain types of agreements to be in writing.

Record Retention Requirements

If the company seeks to use an electronic record to fulfill a record retention requirement under other law, § 101(d)(1) of E-Sign specifies that the electronic record will fulfill the retention requirement if the electronic record accurately reflects the information set forth in the contract or other record and remains accessible by all parties who are entitled to access by statute, regulation, or rule of law (for the time period specified) in a form that is capable of being accurately reproduced for later reference, whether by

transmission, printing or otherwise. A company implementing electronic retention will have to assess what parties are entitled under such laws to access the document, then analyze whether the company can provide a method for such parties to access the electronic record.

Some contracts must be retained in their original form, and consequences may apply if the contract is not retained in its original form. Section 101 (D) (3) specifies that any electronic record that meets the requirements of § 101 (d) (1) also will fulfill any requirement that a contract or other record be retained in its original form and will bar consequences that would otherwise apply if the contract or other record is not provided available or retained in its original form.

The electronic retention requirements of § 101(d)(1) do not apply to any information whose sole purpose is to enable the contract or other record to be sent or communicated by operation of § 101 (d)(2) of E-Sign.

Recommendations Regarding Equivalency to, “Writing” Requirements and Electronic Record Requirements

Any company seeking to use electronic contracts or records to fulfill a requirement that the contract or record be in writing has to ensure that it stores the electronic contract or record in a form that can later be accurately reproduced for later reference by all parties entitled to retain it. If the company does not keep a complete record of the transaction, it may not meet this requirement. Likewise, any company seeking to use an electronic record to fulfill a record retention requirement must be sure it is accurate as to all information set forth in the contract or record, and remains accessible by all parties entitled to access it. The access can be provided by transmission, printing, or otherwise.

Notes

1. Pub. L. No. 106-229, 114 Stat. 464 (2000) (codified at 15 U.S.C. § 7001, *et seq.*).
2. A 2006 Report of the US Census Bureau notes that retail e-sales grew to \$71 billion in 2004, representing an annual increase of 25.2 percent over 2003 and marking an annual growth rate between 2000 and 2004 of 26.4 percent, 2006 Report of the United States Census Bureau on 2004 stats, e-stats, May 25, 2006, www.census.gov/estats.
3. Executive Summary, “Electronic Signatures In Global And National Commerce Act, The Consumer Consent Provision in Section 101(c)(1)(C)(11),” Report of the Department of Commerce and Federal Trade Commission, June 2001, http://www.ftc.gov/os/2001/O6/esign7.htm#N_1_.
4. 15 U.S.C. § 1601, .
5. 15 U.S.C. § 7001(c)(1)(B).
6. 15 U.S.C. § 7001(c)(1)(C).