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Replacing Paper Writings with Electronic Records in Consumer Transactions: Purposes, Pitfalls and Principles

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REPLACING PAPER WRITINGS WITH ELECTRONIC RECORDS IN CONSUMER TRANSACTIONS: PURPOSES, PITFALLS AND PRINCIPLES

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We are in a crucial period for the development of norms for electronic commerce. As David Whitaker rightly notes,[1] electronic records and the Internet can be used for good or ill, for more effective communication and record-keeping, or for new tricks to obscure information or to block access to it.[2] Fringe marketers' use of questionable practices[3] could give the new medium a bad name with customers and regulators in this sensitive period of development, slowing progress toward more electronic commerce, with its potential for cost savings and convenience. Thus, reputable industry players have a self-interest in setting high standards to see that the good uses of the new medium predominate in the marketplace and that bad uses are discouraged and driven out. Regulatory agencies are giving self-regulation a chance to work,[4] but industry exploitation of this environment could backfire in the long run.

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1. R. David Whitaker, *An Overview of Some Rules and Principles for Delivering Consumer Disclosures Electronically*, 7 N.C. BANKING INST. 11 (2003).

2. *See id.* at 12-13; *see also* Jean Braucher, *Rent-Seeking and Risk-Fixing in the New Statutory Law of Electronic Commerce: Difficulties in Moving Consumer Protection Online*, 2001 WIS. L. REV. 527, 539 (concerning potential problems with using electronic records in face-to-face transactions and with web posting of disclosures).

3. *See* Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking about the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589 (2000) (concerning such sub-prime lending sectors as auto-title pawn, payday loans and rent to own, with their aggressive use of loopholes in the law).

4. *See, e.g.*, 66 Fed. Reg. 41,439 (Aug. 8, 2001) (to be codified at 12 C.F.R. §§ 202, 205, 213, 226, 230) (interim final rule lifting mandatory compliance date for standards for using electronic communication under Regulations B, E, M, Z and DD); FED. TRADE COMM'N, DOT COM DISCLOSURES: INFORMATION ABOUT ONLINE

I. PURPOSES OF WRITINGS AND ELECTRONIC RECORDS

To develop appropriate practices concerning use of electronic records, we must keep firmly in mind the many purposes that writings on paper have served and that electronic records will need to serve as well. Five will be discussed.

A. Evidence of making of contract and of terms

Statutes of frauds perform primarily an evidentiary function.[5] They create a requirement, in addition to formation, for the enforcement of a contract. Even if the writing is informal and written after the fact, it can still evidence the making of the contract and satisfy the statute of frauds.[6] Since a minimal writing is often sufficient to meet a statute of frauds, the evidentiary function is principally directed to evidence of the making of the contract and not to the details of its terms. In addition, there are so many exceptions that it is arguable that they have swallowed the rule.[7]

A more complete writing, even though not required by law, can serve a broader anti-fraud purpose by allowing both parties to prove the terms more cheaply and reliably. But for writings to be useful to prove the terms, it must be possible to demonstrate that the document has retained its integrity, a potential problem with electronic records in formats that can easily be changed, either deliberately or inadvertently.

ADVERTISING (2000), *at* http://www.ftc.gov/bcp/conline/pubs/buspubs/dotcom/index.html (last visited Feb. 15, 2003).

5. *See* E. ALLAN FARNSWORTH, CONTRACTS 394 (2d ed. 1990) (concerning the evidentiary function of statute of frauds, sometimes combined with cautionary and channeling functions).

6. *Id.* at 426-427 (concerning the variety of writings that can satisfy the statute, from a letter to a receipt to a pencilled price list).

7. *Id.* at 395-396, 450-460; *see also* U.C.C. § 2-201(3) (2001) (exceptions to statute of frauds); RESTATEMENT (SECOND) OF CONTRACTS § 130 cmt. a (1981) (narrow construction of contract not to be performed within a year); *id.* § 129 & cmt. a (specific enforcement of land contracts based on reliance, derived from part performance doctrine); *id.* § 139 (general exception in cases of reliance).

B. *Facilitating shopping*

Many consumer disclosure statutes and regulations are intended to serve a different primary function, which is to facilitate shopping for the best buy, thus promoting competition.[8] The Truth in Lending Act is a good example of this type of disclosure regime.[9] Disclosures to facilitate shopping and thus competition are only meaningful if made before a decision to enter the transaction. If a disclosure is not made until the customer is already psychologically committed, it comes too late to facilitate the making of the best deal.[10]

C. *Information about remedies after a dispute arises*

Pre-transaction disclosures mandated to stimulate competition also end up serving an important secondary function during the course of the transaction. If available later, they give customers access to terms to determine remedies when a transaction becomes troublesome.[11]

D. *Warnings that terms are substandard; effective disclosure of significant terms*

Yet another purpose of pre-transaction disclosures is to warn customers that they are entering into substandard terms and should proceed with caution. Thus, under the Magnuson-Moss Warranty Act and its implementing regulations, limitations on duration of implied warranties and exclusions of consequential damages in consumer product sales must be clearly and conspicuously disclosed.[12] As in the best-buy model, a warning of

8. Jean Braucher, *Delayed Disclosure in Consumer E-Commerce as an Unfair and Deceptive Practice*, 46 WAYNE L. REV. 1805, 1809-1818 (2002) (concerning the importance of both effective disclosure and substantive fairness).

9. Truth in Lending Act, 15 U.S.C. § 1601 (2000) (implemented by 12 C.F.R. pt. 226).

10. William C. Whitford, *The Functions of Disclosure Regulation*, 1973 WIS. L. REV. 400, 448-449 (discussing desirability of disclosure prior to commitment).

11. *Id.* at 464-465.

12. Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301, 2308 (2000); 16 C.F.R. § 701.3(a)(7)-(8) (2002).

substandard terms is most effective if given before the consumer makes a decision to enter the transaction.[13]

The Federal Trade Commission has broadened the warning purpose to require effective communication of all the material information prior to consummation of a deal, and even earlier in advertising.[14] Only when fully informed about key features of the product and contract terms can a consumer avoid bad deals or deals inappropriate for the consumer's needs.

E. Notice of later risks

Another function of writings is to alert customers to new information or risks as a result of post-transaction events. Product recall notices fall in this category, as do warnings of a possible loss of benefits of a transaction due to apparent default, which give the customer a chance to correct billing errors or to cure missed performance obligations. Notices of default, foreclosure, or termination of rights (utility shutoff, health insurance coverage) are examples. These sorts of notices are excepted from the federal electronic record enabling statute because increased risk of non-receipt is not tolerable given the importance of the information.[15]

II. PITFALLS OF ANALOGIES TO THE PAPER WORLD

Some of the enabling laws for electronic commerce do not reflect a full appreciation of the differences between paper writings and electronic records.[16] Businesses seeking to serve their customers well should be more sensitive than the law to these

13. *See* 16 C.F.R. § 702 (concerning pre-sale availability).

14. FED. TRADE COMM'N, POLICY STATEMENT ON DECEPTION (1983), *reprinted in In re* Cliffdale Assocs., Inc., 103 F.T.C. 110, 174 app. (1984) (e.g., omission of information on quality and warranties is presumed material).

15. Electronic Signatures in Global and National Commerce Act (E-Sign), 15 U.S.C. § 7003(b)(2) (2000) (exceptions for utility cancellation, default and foreclosure notices, eviction notices, termination of health and life insurance benefits, and product recalls). Some versions of the Uniform Electronic Transactions Act (UETA) have picked up these requirements, although the uniform version of UETA does not state them.

16. UETA in its uniform version, in contrast to E-Sign, lacks consumer consent provisions and exclusions for important consumer notices. *See supra* note 14.

differences. When thinking about the limits of the effectiveness of electronic records, it is important to remember that electronic records are not only used in transactions over the Internet, but also in face-to-face dealings, where the business lacks direct evidence that the customer will have access to electronic records later.

A key difference between electronic records and paper writings is that receipt and storage of paper do not depend on consumer access to expensive technology. The biggest problem with paper records is finding them later. Receipt is easy. In contrast, to receive an electronic record, one must have access to a computer with compatible software as well as access to the Internet.[17] To save a record for later access, one must also have continuing electronic storage capability or a printer to produce a paper copy.[18] It may be important to maintain compatible hardware, software and Internet connections over a long period of time to receive and access notices during the life of a contract that lasts a number of years, such as a home or car loan. E-mail addresses change frequently, typically more often than residential addresses, and forwarding systems are rudimentary or often not in place at all.[19] Consumers buy new equipment and software, and may experience difficulties retaining access to old electronic records.

While all but the illiterate and the blind are comfortable with the use of paper writings, there is a much larger group of people who are not comfortable with computer technology and the Internet. There is still a digital divide concerning electronic records, one that disproportionately affects the poor, the uneducated, minority communities, the elderly and immigrants.[20]

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17. *See* 15 U.S.C. § 7001(c)(1)(C)(i) (requiring that prior to consenting to electronic records, the consumer be informed of hardware and software requirements for access to and retention of electronic records). E-Sign reflects understanding of these requirements in its consumer consent provisions. *See id.*

18. *See id.* § 7001(c)(1)(C)(i), (D) (requiring disclosure of revised hardware and software requirements when changes in systems are made).

19. Braucher, *supra* note 2, at 540 & n.62 (concerning address changes and lack of forwarding of e-mail).

20. *See* NAT'L TELECOMM. & INFO. ADMIN., A NATION ONLINE: HOW AMERICANS ARE EXPANDING THEIR USE OF THE INTERNET 11-29 (Feb. 2002), http://www.ntia.doc.gov/ ntiahome/dn/anationonline2.pdf (last visited Feb. 15, 2003).

Some people will find electronic records more reliable than paper, facilitating their ability to store them, while at the other end of the spectrum, many people still do not have access to computers and the Internet. Others do not consistently maintain access; they may sign up for a period and then let their access lapse. Industries should proceed cautiously in the use of electronic records, not getting ahead of any sector of their customer base. Unless a business deals only with sophisticated Internet users, businesses should expect to maintain systems to provide paper writings for some customers for a number of years to come.

III. SOME KEY PRINCIPLES

With this background in mind, some principles of businesses' effective use of electronic records can be developed. These overlap to a considerable extent with those listed by David Whitaker.[21] I have attempted to make statements of principle that are conceptual rather than operational.

A. Respect your customers' level of electronic sophistication

It is a recipe for trouble to be driving customers to use electronic contracting and electronic records before they are ready. If you know that some of your customers do not maintain a reliable Internet connection, you should have backup paper systems. If you are planning a business model where electronic access is essential, make that clear and do not market the model to customers who do not demonstrably have access.

As of Sept. 2001, about fifty-four percent of Americans were using the Internet. *Id.* at 1; *see also* NAT'L TELECOMM. & INFO. ADMIN., PERCENT OF U.S. HOUSEHOLDS WITH A COMPUTER, BY INCOME, http://www.ntia.doc.gov/ntiahome/dn/hhs/ChartH2.htm (last visited Feb. 15, 2003) (showing computer ownership, as of 2001, declining with lower income).

21. Whitaker, *supra* note 1, at 24-26.

B. *In face-to-face dealings, provide paper copies*

The law may not require this,[22] but it is good business practice to provide paper copies of documents used or produced during in-person dealings. Door-to-door salesmen with laptops or kiosk marketers should have paper copies on hand or printers to produce them.

C. *Paper back-up systems will often be necessary even in transactions entered into on-line*

Even though a transaction is entered into on-line, if later communications are going to be necessary (such as a product recall, a foreclosure notice, or a renewal with new terms), paper delivery systems will be needed, in some cases by legal mandate. Some later notices must be provided in paper writings,[23] and in other cases, a bounce-back of an electronic message will make it prudent to redeliver an electronic message to a residential mailing address in the business's files.[24]

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22. For consent to electronic records, E-Sign requires that the consumer consent electronically or confirm consent electronically "in a manner that reasonably demonstrates that the consumer can access the information in the electronic form that will be used to provide the information." 15 U.S.C. § 7001(c)(1)(C)(ii). Furthermore, where there is a writing requirement, electronic records may be denied validity if "not in a form that is capable of being retained and accurately reproduced for later reference by all parties." *Id.* § 7001(e). In face-to-face dealings, there will be no electronic demonstration of the consumer's ability to access electronic records later. *See id. But see* Interim FRB Rule, staff commentary to 12 C.F.R. §§ 226.36, 36(b)(6) (suggesting that it might be permissible to send disclosures by e-mail or to post them to a web site, even though dealing face to face with a customer and providing disclosures using the creditor's equipment).

23. *See supra* note 15 (listing certain E-Sign exceptions where paper is required).

24. *See* 12 CFR § 226.36(e) (interim rule providing for redelivery after return, using information in a business's files); *see also* 12 C.F.R. § 226, Supp. I (official staff commentary on 12 C.F.R. § 226.36(e)) (calling for redelivery to a different e-mail or postal address that the creditor has on file after a return of an e-mail as undeliverable). The mandatory compliance date for this rule has been lifted. *See supra* note 4.

D. *Test ability to access later electronic records and make it a marketing plus*

As part of consent to use of electronic records, E-Sign requires a test of ability to access and retain records of the type that might be sent.[25] I agree with David Whitaker that businesses should plan on complying with this aspect of the law.[26] But rather than viewing this consumer access test as akin to a dose of castor oil, businesses should welcome it as a way to reassure customers. The test can be presented in a way that will improve customer relations. An analogy is plain language laws, which businesses have used to improve marketing and customer relations.[27]

E. *Monitor customer behavior and change disclosure practices to assure access*

Web-posting of disclosures and notices may not be an effective means of communication. This may be true even if the customer is sent an e-mail with a hot link to the web site or an attachment.[28] In electronic commerce, it is possible to monitor whether links are being used or attachments opened or saved by most customers. If customers are not accessing mandated disclosures before entering into a transaction, it is advisable to find a new, more effective way to provide access, such as including the message in the body of an e-mail or as part of a screen that cannot be by-passed.[29]

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25. *See supra* note 22.

26. *See* Whitaker, *supra* note 1, at 15.

27. *See* Note, *New York's Plain English Law*, 8 FORDHAM URB. L.J. 451 (1980).

28. *See* 12 C.F.R. § 226.36(d)(2) (providing for some form of notice in addition to web posting, although not necessarily requiring a hot link and perhaps even making a paper notice sufficient).

29. *See* 12 C.F.R. § 226, Supp. I (official staff commentary on 12 C.F.R. § 226.36(b)(3)) (concerning disclosures where by-pass should not be possible).

F. *Make terms available in advance of psychological commitment*

Early availability of terms, before a decision to make a transaction, is an important principle in contracting and consumer protection generally, no less so in the electronic environment.[30] Thus, requiring a customer to click an "order" button or the like before going through required or important information is a substandard practice, one that interferes with the "best buy" model of disclosure.[31]

G. *Changes in terms require special procedures to assure notice and assent*

Consumer protection enforcement actions have focused on misleading or unfair practices with respect to changes in terms, such as price increases or loss of aspects of service.[32] If, for example, a consumer signs up for an initial term of access to an online service, notice should be given at that time that price and services may change upon renewal. Furthermore, when the renewal date arrives, it is safest to get active assent after disclosure, requiring the customer to send a message or to click to sign up for renewal. The customer should have a clear option to terminate the service to avoid the changed terms.[33] Blanket assent to later changes, given at the time of contracting, is insufficient. Tricky practices with respect to renewal are very annoying to customers. They are not a recipe for long-term customer loyalty or trouble-free relationships with regulators.

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30. *See* Christina L. Kunz et al., *Click-Through Agreements: Strategies for Avoiding Disputes on Validity of Assent*, 57 BUS. LAWYER 401 (2001). The failure to require pre-transaction availability of terms (prior to order or payment) has been a key reason for the controversy over the proposed Uniform Computer Information Transactions Act. *See* U.C.I.T.A. §§ 112, 208, 209 (2002).

31. *See* Whitford, *supra* note 10, at 448-49.

32. Press Release, Federal Trade Comm'n, America Online, Compuserve and Prodigy Settle FTC Charges Over "Free" Trial Offers, Billing Practices (May 1, 1997) (concerning failure to alert customers of the need to cancel free service to avoid charges), *at* http://www.ftc.gov/opa/1997/9705/online.htm.

33. *Id.*

H. Required electronic records that might serve an evidentiary purpose in a later dispute should be provided to customers in a format that maintains its integrity

E-Sign indicates that document integrity is required. It states that required writing requirements can be met with electronic records but may be denied effect "if such electronic record is not in a form that is capable of being retained and accurately reproduced for later reference by all parties . . . ."[34] A word processing file is too easily changed to meet this test. Furthermore, it is a matter of fundamental fairness that the customer should get a copy that has as much evidentiary validity as the copy retained by the business.

IV. CONCLUSION

As financial institutions and other mainstream businesses adapt their practices to make use of electronic records and online marketing, they are inevitably helping to set standards for electronic commerce. For the time being, regulators are waiting and watching, giving self-regulation a chance. Customers are gradually becoming more comfortable with the new medium. Short-term benefits from substandard practices may come at the cost of alarming or alienating one or both of these audiences. The development of electronic commerce will be best served in the long run if leading industries set standards high. They should be sensitive to their customers' degree of electronic sophistication and make good faith efforts to meet the objectives of various requirements for records, which range from an evidentiary function to the facilitation of shopping and dispute resolution.

34. 15 U.S.C. § 7001(e) (2000).