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DISPATCHES FROM THE TRENCHES

E-SIGN: a Necessary Element of E-Commerce Legislation Impacting the Leasing Industry

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I. INTRODUCTION

Electronic commerce has enabled leasing companies to benefit from cost and time efficiency, and many companies use the Internet and other e-commerce technology in connection with leasing transactions. For example, leasing companies use electronic commerce for prospecting, for the circulation of proposals, term sheets, and other correspondence, and for pricing and asset tracking.

Despite the benefits of electronic commerce, many leasing companies have been reluctant to enter into entirely electronic transactions because of fears about the enforceability of electronic, paperless contracts that do not bear traditional signatures. Although many of these fears have been addressed by recent legislation, the legal landscape governing electronic leasing transactions is still being formed. This article provides a general overview of some recent legislation impacting the enforceability of electronic leasing transactions with a particular emphasis on the Electronic Signatures in Global and National Commerce Act (e-Signö) and how that statute fits into the current legal regime addressing e-commerce and its effect on leasing.¹

¹ 15 U.S.C. § 7001-7031 (2000).

II. GENERAL OVERVIEW OF GOVERNING STATUTES AND THE IMPORTANCE OF E-SIGN

In the same way that leasing companies offer myriad types of financing alternatives, many statutes shape the body of law governing such transactions. The main two pieces of legislation that govern the execution of leases and their enforceability as binding contracts between two parties are Articles 2A and 9 of the Uniform Commercial Code (the "UCC").² Article 2A governs the execution of "true leases", such as a lease with a fair market value purchase option. Article 9 governs the execution of leases that constitute "loans" or "leases intended as security", such as a "dollar out lease" or a lease with a mandatory purchase option.

Article 9, which was recently revised,³ addresses important issues raised with respect to electronic leasing transactions. As revised, Article 9 is medium neutral and uses terms such as "authenticating a record" instead of "signing a writing."⁴ In addition, the revisions to Article 9 theoretically allow for the transfer of electronic chattel paper in either a sale or loan transaction.⁵ Although the National Conference of Commissioners on Uniform State Laws is recommending similar changes to Article 2A,⁶ the version currently in force does not satisfactorily address electronic signatures. For example, the current version of Article 2A provides that a lease contract is unenforceable unless "there is a *writing, signed* by the party against whom enforcement is sought. . . ."⁷

Since most leasing companies enter into leases that are "loans" and leases that are "true leases," and since some courts have trouble distinguishing between the two,⁸ the potential problems caused by Article 2A's failure to address electronic signatures impacts the entire leasing industry. Fortunately, E-Sign provides comfort to those wishing to enter into electronic contracts that may constitute true leases governed by Article 2A. Similarly, E-Sign provides comfort with respect to the electronic execution of other documents that are often used in leasing transactions but which fall outside the scope of the medium neutral language contained in Article

² Other statutes govern different aspects of leasing transactions such as the income and property tax consequences of leases or the liability of the lessor or lessee for injuries caused by leased equipment.

³ Article 9 became the law in Alabama, Florida and Mississippi on January 1, 2002, in Connecticut on October 1, 2001 and in the other forty-six states on July 1, 2001.

⁴ See e.g. U.C.C. §§9-203(b)(3)(A); 9-102(a)(7); 9-102(69).

⁵ See §III(c) of this article for more information on the transfer of electronic chattel paper.

⁶ For example, the proposed revisions to §2A-222 state that "[a] record or signature may not be denied legal effect or enforceability solely because it is in electronic form" and the proposed revisions to §2A-204(4) allow for lease contracts to be formed through electronic agents. See Draft of Proposed Amendments to UCC Article 2A for Leases, available at <http://www.law.upenn.edu/blil/ucc2a/ann0612.htm>.

⁷ See U.C.C. §2A-201(1)(b) (emphasis added).

⁸ See e.g. *Amba-An v. A. Arias-Turecios*, 704 So.2d 1093 (Fla. Dist. Ct. App. 1997) (court ruled that a lease with a one dollar purchase option was a "lease" rather than a "conditional sale contract" or a "loan" for purposes of holding a lessor liable under Florida's dangerous instrumentality doctrine).

9. Examples include guaranties, repurchase agreements and other assorted side letters used as additional credit support as well as vendor program agreements, broker program agreements and assignment and assumption agreements.

III. SUMMARY OF E-SIGN

On June 30, 2000, former President Clinton signed into law E-Sign and it became effective on October 1, 2000. Although the national media made quite a stir of its passage, most media organizations failed to fully explain the legislation. As a result, many businesses remain uninformed as to E-Sign's significance and may not be using certain efficiency measures that E-Sign sanctions. E-Sign is a federal act of validation that implements a national uniform standard for electronic signatures and contracts.⁹ E-Sign provides to contractual parties legal standards upon which they may rely to enforce each other's agreements electronically, and removes real and perceived legal obstacles to the use of electronic contracts. For purposes of this article, E-Sign's most important aspect is that it grants equal legal status to electronic signatures as is given to handwritten signatures, and to electronic contracts as is given to paper contracts if part of a transaction in or affecting interstate or foreign commerce. This article is intended to provide a practical and useful summary of E-Sign as it relates to the execution and validity of electronic signatures and electronic contracts.

A. General Rule of Validity

Congress passed E-Sign in part to promote the acceptance and use of electronic signatures and electronic contracts.¹⁰ The general rule that E-Sign implements, and which accomplishes this objective is set forth in Section 7001(a), which provides in relevant part:

Notwithstanding any statute, regulation, or other rule of law . . . , with respect to any transaction in or affecting 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,

⁹ E-Sign also has provisions not addressed in this paper that relate to, among other areas, consumer notices and disclosures and electronic record keeping.

¹⁰ See 15 U.S.C. § 7031.

validity, or enforceability solely because an electronic signature or electronic record was used in its formation.

The thrust of E-Sign is that signatures or contracts used in transactions affecting interstate or foreign commerce may not be denied legal effect or enforcement solely because they are in electronic form. As such, E-Sign elevates electronic contracts to a level which satisfies statutory requirements that contracts be in writing and that they be signed by the party against whom or which enforcement is sought (*e.g.*, the Statute of Frauds). The effect of E-Sign is procedural only and does not change any substantive rights. Consequently, for all of its perceived grandeur, E-Sign accomplishes little more than tackling a question the answer to which had been shrouded by an underlying fear and suspicion of the new.

B. Limitations on, and Exceptions to, the Scope of E-Sign

Congress imposed two significant limitations on E-Sign's scope. First, E-Sign does not limit, alter, or otherwise affect any requirement imposed by a statute, regulation, or rule of law relating to the rights and obligations of persons under such statute, regulation, or rule of law other than a requirement that contracts or other records be written, signed, or in nonelectronic form.¹¹ By preserving all requirements unrelated to the writing, signing and form of contracts, this limitation emphasizes the procedural nature of E-Sign over its substantive effect. Moreover, this limitation does not affect applicable defenses to traditional handwritten contracts (*e.g.*, forgery, fraud, impossibility). Accordingly, if a statute, regulation, or rule of law requires a contract to be in writing to be enforceable, an electronic contract bearing electronic signatures that is otherwise enforceable will be invalid if, for example, its agreements are unsupported by consideration.

Second, E-Sign does not require a person . . . to agree to use or accept electronic records or electronic signatures . . .¹² Therefore, if one party to a contract insists upon execution by handwritten signatures and retention of a paper copy of the contract, any other party to the contract must abide by the insisting party's demand. E-Sign does not carry any provision that could be used to force the unwilling party to contract electronically. As stated, E-Sign tackles the fear of the new, but, as this limitation shows, does not force contractual parties to accept the new.

¹¹ 15 U.S.C. § 7001(b)(1).

¹² 15 U.S.C. § 7001(b)(2).

In addition, E-Sign contains several exceptions to which its general rule of validity will not apply, many of which are consumer protection oriented.¹³ Also, E-Sign does not apply to the Uniform Commercial Code, as in effect in any State, *other than* section 1-107¹⁴ concerning waiver or renunciation of claims or rights after breach, section 1-206¹⁵ which sets forth the UCC's version of the Statute of Frauds, Article 2 concerning sales and Article 2A concerning leases.¹⁶

¹³ For example, E-Sign does not apply to a contract to the extent it is governed by a statute, rule, regulation or other rule of law governing the creation and execution of wills, codicils, or testamentary trusts or a state statute, regulation, or other rule of law governing adoption, divorce, or other matters of family law. 15 U.S.C. §§ 7003(a)(1).

¹⁴ Section 1-107 provides: "Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party."

¹⁵ Section 1-206 provides:

(1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount of value of remedy unless there is some writing in which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contracts for the sale of goods (Section 2-201) nor of securities (Section 8-113) nor to security agreements (Section 9-203).

¹⁶ 15 U.S.C. § 7003(a)(3).

C. Retention of Contracts and Records

If a contract or other record is required by other law to be in writing, such as a true lease under Article 2A of the UCC, the:

legal effect, validity, or enforceability of an electronic record of such contract or other record may be denied if such electronic record is not in a form that is capable of being retained and accurately reproduced for later reference by all parties or persons who are entitled to retain the contract or other record.¹⁷

This provision only requires that the form of electronic record be one that is *capable of being retained* and E-Sign does not impose any specific requirement that the record in fact be retained or that any particular persons have access to the record.¹⁸

Importantly, E-Sign does not address which person has possession of the sole original counterpart of an electronic lease, irrespective of whether it is a true lease or a lease intended as security. That issue, which is very important to brokers, funders and other leasing companies involved in the syndication of leases, is addressed under the revised version of Article 9 of the UCC. Section 9-105 of Article 9 addresses the transfer of electronic chattel paper¹⁹ in either a sale or loan transaction. That section establishes control over a single, authoritative copy of an electronic lease as the equivalent of the physical delivery and possession of a signed original of a paper lease. The single, authoritative copy or record of an electronic lease must be maintained by the purchaser of, or the secured party holding an interest in, the lease and must be unique, identifiable and generally unalterable.²⁰ It must be able to be revised to show additions or changes to the identified assignee or amendments and any revision must require the participation of the party having such control and must be readily identifiable as an authorized or unauthorized revision.²¹ Similarly, any copies must be readily identifiable as authorized copies.²² Although companies are emerging which offer services satisfying these rigorous

¹⁷ 15 U.S.C. § 7001(e).

¹⁸ Although E-Sign defers to other law with respect to *whether* a record must be retained, it provides specific guidance as to how to comply with any such requirement imposed by other law. See 15 U.S.C. 7001(d)(1) (if a statute, regulation, or other rule of law requires that a contract be retained, that requirement is met by retaining an electronic record of the information in the contract that (A) accurately reflects the information set forth in the contract; and (B) remains accessible to all persons who are entitled to access by statute, regulation, or rule of law, for the period required by such statute, regulation or rule of law in a form that is capable of being accurately reproduced for later reference, whether by transmission, printing, or otherwise.) Note however, that the filing and retention of Financing Statements is governed by Article 9 of the UCC.

¹⁹ See U.C.C. §§9-102(a)(11) and (a)(31) (defining electronic chattel paper as a record which consists of information stored in an electronic medium and which evidences a monetary obligation and a security interest in specific goods or a lease of specific goods).

²⁰ U.C.C. §9-105(1)

²¹ U.C.C. §§9-105(4) and (6).

²² U.C.C. §9-105(5).

requirements,²³ many leasing companies that are comfortable with the electronic execution of leases still print out a hard copy to mark and use as the sole original counterpart in connection with any assignment of the lease.

D. What is an Electronic Signature?

A "signature" has been defined generally as "the name or mark of a person, written by that person at his or her discretion."²⁴ More precisely, the term "signature" is defined as "any symbol executed or adopted by a party with present intention to authenticate a writing."²⁵ The common thread that attaches the preceding definitions, at least with respect to the execution of a contract, is that a party must adopt some identifying mark by which such party intends to be bound. Traditionally, any mark, symbol or device one may choose to employ as representative of oneself has been sufficient.

E-Sign's approach to electronic signatures is merely a logical extension of the traditional notions of what constitutes a signature. E-Sign defines the term "electronic signature" 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." Though broader in some respects, E-Sign's definition of electronic signature essentially replicates the more traditional definition of a signature. The obvious difference is the added element of "electronic," which E-Sign has defined as "relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities." Examples of electronic signatures include digital signatures (created by use of public key cryptography), a scripted font signature created from commonly used word processing software or the typing of one's name at the end of an email message. Less obvious examples that are no less common include personal identification numbers ("PINs") for access to, among other things, automated teller machines, passwords used to access, for example, web-based retail sites, smart cards, retinal scans and fingerprint recognition. E-Sign is "technology neutral," and does not give greater legal status or effect to any particular technology.

²³ See e.g. www.eoriginal.com

²⁴ BLACK'S LAW DICTIONARY 1382 (6th ed. 1990).

²⁵ U.C.C. § 1-201(39) 1998.

IV. CONCLUSION

E-Sign is an important element of e-commerce legislation necessary to the leasing industry and attempts to remove real and perceived legal obstacles to the use of electronic contracts to facilitate e-commerce activities. E-Sign accomplishes this goal by pronouncing the validity of electronic signatures for interstate and international commerce and by erasing doubts as to the legal effect of certain electronic contracts which bear electronic signatures. As e-commerce continues to grow in popularity, the discussion of, though not necessarily the importance of, E-Sign with respect to electronic contracting will likely diminish because its effect will no longer be noteworthy as much as it will be accepted.

Until then, although E-sign pushes the leasing industry one step closer to a world in which the electronic documenting of leasing transactions is done efficiently and safely. Nonetheless, numerous complexities still exist²⁶ with electronic leasing transactions and counsel should be consulted thoroughly prior to engaging in any such transactions.

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²⁶ For example, in some states adoption of the Uniform Electronic Transactions Act, also known as "UETA" preempts E-Sign but only to the extent those states' versions of UETA are consistent with E-Sign.