

INSURANCE UNDER ESIGN

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Introduction

This Article discusses the recently enacted Electronic Signatures in Global and National Commerce Act¹ (the “Act” or sometimes referred to as “ESIGN”) with a particular emphasis on how ESIGN applies to B2B and B2C transactions² in the U.S. insurance industry. The topic of electronic signatures³ is particularly relevant today with the rush by carriers, intermediaries and suppliers to complete more of the business of insurance online. Consider the following comments from Senator Wyden from Oregon, speaking on June 15, 2000 (just before ESIGN’s passage) on the significance of the Act to the insurance industry:

But as we prepared – after this passed the Commerce Committee – to move forward with a pretty innocuous bill, the financial services and insurance industries came to us with what we thought was a very important and thoughtful concept; and that was to revolutionize e-commerce, to go beyond establishing the legal validity of e-signatures to include electronic records, keeping important records electronically. We were told by industry – and correctly so – that this would give America a chance to save billions and billions of dollars and thousands of hours, as our companies chose to spend their funds on matters other than paper recordkeeping.

The Act contains a number of provisions outside insurance-related B2B and B2C transactions and those topics are outside the scope of this Article.⁴

In very broad terms, the Act provides that contracts formed using “electronic signatures”⁵ on “electronic records”⁶ will not be denied legal effect *solely* because they are electronic.⁷ It is important to recognize that the Act is “technology neutral” in that it does not specify any particular type of electronic signature or electronic record. The Act does not require the use of third party “certification authorities” who independently validate electronic signatures and records. Simply because a contract is formed electronically, the Act does not afford it more or less weight than if formed the traditional way. The Act does not require parties to contract electronically.⁸

It is important to appreciate that ESIGN does not validate all electronic contracts; it merely provides that no rule of law may deny enforceability of an electronic contract *solely* because it was formed electronically. The party seeking to enforce the electronic contract will still have the same burdens to establish contract formation and the terms of that contract and therefore ESIGN does not change the motivation for parties to memorialize, in a reliable medium, the contract (executing a record containing all the terms) for future reference.

For example, a carrier accepting applications online will need the appropriate systems to receive, archive and retrieve an electronic signature attached to or logically connected with the electronic application to enable the carrier to submit as evidence in a court of law an authenticated hard copy of that contract and to prove both the party’s intent to be bound by and the actual contents (or lack thereof) of the application for insurance. Such systems will need to remain in place for the duration of the contract, plus the appropriate statute of limitations period. The consumer, whose electronic signature appears on the electronic application, will still have the defense that it is not his signature, that he did not intend to sign the contract, or that the application he signed differs from the hard copy of the electronic application provided.

The Act also permits certain record retention requirements imposed by statutes to be met by retaining the electronic records, rather than the hard copies.⁹ This will be particularly significant to the paper-intensive insurance and financial services industry, as noted in the remarks of Senator Wyden.

Effective Dates

The provisions applicable to contracts take effect October 1, 2000.¹⁰ The Act is silent as to whether only transactions entered into on or after October 1, 2000 are governed by the Act or whether transactions entered into prior to October 1, 2000 and which otherwise meet the requirements of the Act are also within the scope of the Act. The provisions applicable to satisfying the record retention requirements imposed by statutes take effect March 1, 2001, unless delayed

as provided.¹¹

Preemption

First and foremost, the Act applies to the “business of insurance.”¹² Further, the Act provides that State laws or any other rule of law may modify or supersede the contract formation provisions of the Act only in very limited circumstances.¹² Generally, a State’s adoption of the Uniform Electronic Transactions Act (“UETA”) promulgated by the National Conference of Commissioners on Uniform State Laws in a manner consistent with the Act, would not be preempted. For example, California adopted UETA but in doing so excluded several provisions of the insurance code from its scope. These inconsistent provisions of California’s version of UETA will be preempted. In addition, a State’s adoption of UETA with an alternative procedure or requirement for electronic signatures or electronic records is not preempted only if such alternative is consistent with the Act and makes reference to this Act.¹⁴

As a practical matter, insurance firms developing and implementing a multi-state e-commerce strategy can now look to the uniformity of E-SIGN and consistent state equivalents for the requirements to contract electronically. As stated by Senator McCain in the Conference Committee Report, “This bipartisan legislation can eliminate this unnecessary barrier to the growth of electronic commerce by providing consistent, fair rules governing electronic signatures and records. This bill will do the following: It would ensure that consistent rules for validating electronic signatures and transactions apply throughout the country, thus providing industry with the legal certainty needed to grow electronic commerce.” The Act does exclude from its scope certain transactions.¹⁵ Several of these are directly applicable to the insurance industry and to this extent, insurance firms must continue looking to state laws for guidance.

Consumer Disclosures

When E-SIGN disclosures are required. The Act requires disclosures regarding the electronic contracting process to consumers only when another rule of law requires written disclosures about the underlying transaction.¹⁶ (For example, Insurance Codes typically require certain information regarding replacement life insurance to be provided to the insured prior to issuing the replacement coverage.) In the absence of another rule of law mandating disclosure about a transaction, E-SIGN does not itself require any particular disclosures or consents to consumers.

E-SIGN disclosure. When disclosure under E-SIGN is required, the consumer must have: (i) affirmatively agreed to transact business electronically and not have withdrawn that consent;¹⁷ (ii) been provided a clear statement informing him of his right to receive the electronic or hard copy edition of the record and the right to withdraw consent at any time and the consequences of doing so (which could include additional fees or termination of the relationship);¹⁸ (iii) been told of the scope of the consent and whether such consent applies to only one transaction or to one or more categories of transactions;¹⁹ (iv) been informed of the procedures for withdrawing consent prospectively and how to update the information needed to contact the consumer;²⁰ (v) been informed of how to request a hard copy of an electronic record and whether there is any fee for doing so;²¹ and (vi) been informed of the hardware and software requirements to access and retain the electronic records.²² Finally, the consumer must then consent electronically or confirm his consent electronically in a way demonstrating the consumer can access the foregoing information in electronic form.²³

If the hardware and software requirements change, the consumer must be notified and given the opportunity to withdraw consent without any imposition of fees for such withdrawal of consent and without any consequence not previously disclosed.²⁴ The consumer must then again consent electronically or confirm his consent electronically, in a way which demonstrates the consumer can access the foregoing information in electronic form under the new hardware and software configuration.²⁵

Consequence of not providing the required disclosure and obtaining consent. The legal effectiveness of the electronic contract will not be denied solely because the informed consent referred to above was not obtained in accordance with Section 101(c)(1)(C)(ii).²⁶ In the insurance industry, there is a variety of required disclosures in tandem with the insurance contract. For those insurance contracts requiring disclosures in conjunction with the contract, carriers contracting electronically will need systems that receive, archive and retrieve not only the underlying application and contract, but also the evidence to establish the consumer’s consent to receive such disclosures electronically.

Agents and brokers protected. The Act has a special provision for insurance agents and brokers. An agent or broker who follows the procedures established by the carrier (assuming the carrier and not the insured established the procedure)

will not be held liable for any deficiency in the electronic procedures agreed to by the parties if the agent or broker was not negligent, was not involved in establishing the procedures and did not deviate from the procedures.²⁷ Thus, agents and brokers are entitled to rely on the electronic procedures established by the carriers. Further, agents and brokers participating in designing and implementing a carrier's electronic contracting process risk losing this limited exculpation.

Acknowledged Receipts

Insurance Codes also require the insureds to acknowledge receipt of certain disclosures. E-SIGN permits such disclosures to be provided electronically only if the method of providing the information electronically also provides verification or acknowledgment of receipt (whichever is required by the statute requiring the disclosure).²⁸ This could be problematic for carriers and intermediaries dealing with consumers exclusively online because it will be difficult to provide eyewitness testimony of such actual delivery. Technologies are available for reliable and secure use of an electronic signature, but unless properly implemented, it could still be very difficult to prove actual receipt.

Denial of Legal Effect

Although failing to comply with E-SIGN's consumer disclosure requirements will not necessarily result in unenforceability of the electronic contract, if a rule of law requires a contract (or other record) to be in writing, the legal effect of the electronic contract may be denied if the electronic record is not in a form capable of retention and retrieval for later reference by all parties to that contract.²⁹ The Conference Committee Report further explains that each party must be able to retain and each party must be able to retrieve the electronic contract, otherwise the contract loses its validity: "The Conferees added new language in Section (e) of 101 to establish that a contract or record which is required under other law to be in writing loses its legal validity unless it is provided electronically to each party in a manner which allows each party to retain and use it at a later time to prove the terms of the record."

An obvious example of a law requiring a contract to be in writing is the statute of frauds. The Insurance Codes also contain a number of requirements that the application for insurance be in writing, the policy be in writing and that the agent appointment be in writing. To the extent carriers rely exclusively on the electronic edition of the contract, they should ensure that the insured not only has the electronic record, but is provided access to the appropriate systems to receive, archive and retrieve the electronic contract.

Until electronic safe deposit boxes with the appropriate systems to confidently receive, archive and retrieve electronic documents from a variety of sources are widely used by insureds, carriers should consider forming the contract electronically at "internet speed" but providing the hard copy of the electronic record to the insured in due course, rather than run the risk of the insured not maintaining the necessary systems to archive and retrieve the electronic contract later. The carrier could still archive its "original" in electronic form only, for later retrieval, thereby enjoying the efficiencies of electronic storage.

Merger/Integration Clauses

Well drafted contracts contain a merger or integration clause,³⁰ a clause stating that the agreement can be amended only in a writing signed by the parties,³¹ and a provision that no party is deemed to have waived its rights unless it has done so in a writing duly signed.³² Together, these provisions provide confidence to the parties that all the terms of the contract are contained in the writing duly signed and that amendments (including waivers) require the same formalities, i.e., another writing with appropriate signatures. The objective is to prevent parol or extrinsic evidence from being used to contradict what is within the four corners of the written contract duly signed by the parties.

Contracting electronically does not change the importance of such provisions. Contracting electronically will, however, require parties to adopt procedures to ensure that only authorized persons apply electronic signatures to amendments to contracts. From a carrier's perspective, the process of dealing with insureds electronically should be carefully re-examined to make sure there are no electronic amendments or waivers being inadvertently signed electronically, as the ability to form contracts electronically provides another avenue, intentionally or inadvertently, for contracts to be formed or modified. Carriers contracting over the Internet may want to have a separate statement at their website describing the process for contracting electronically.

Conclusion

ESIGN will facilitate issuing more insurance over the Internet as the burdens of inconsistency of the laws of fifty states regarding recognition of electronic signatures and contract formation are reduced. Carriers, intermediaries and suppliers will now be able to adopt a more unified and efficient national contracting strategy. As a result, we are likely to see an emergence of first movers or a new breed of intermediaries with systems enabling insureds and carriers to efficiently and confidently receive, archive and retrieve electronic contracts.

Endnotes

1. Pub. L. No. 106-229, 114 Stat. 464 (2000).
2. B2B are business to business transactions (such as carrier to agent dealings) and B2C are business to consumer transactions (such as carrier to personal lines insured dealings).
3. References throughout are to “electronic” signatures, which are different from “digital” signatures. For purposes of this Article, the term “electronic” signatures includes “digital” signatures. For a general description of electronic and digital signatures, *see*, www.silanis.com, a website maintained by Silanis Technology, Inc., a provider of electronic signature solutions.
4. For example, the Act directs the Secretary of Commerce to conduct certain studies, as well as contains an entire scheme for “transferable records” which relate to certain types of debt instruments governed by UCC Article 3.
5. 106 P.L. 229, § 106(5): “(5) ELECTRONIC SIGNATURE - The term ‘electronic signature’ means 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.”
6. 106 P.L. 229, § 105(4): “(4) ELECTRONIC RECORD - The term ‘electronic record’ means a contract or other record created, generated, sent, communicated, received, or stored by electronic means.”
7. 106 P.L. 229, § 101(a).
8. For the reasons discussed in this Article, insurance companies should proceed carefully in contracting electronically, at least in the areas of the insurance application and the insurance policy.
9. 106 P.L. 229, § 101(d).
10. 106 P.L. 229, § 107(a).
11. 106 P.L. 229, § 107 (b)(1)(A).
12. 106 P.L. 229, § 101(i) states, “(i) INSURANCE - It is the specific intent of the Congress that this title and title II apply to the business of insurance.”
13. 106 P.L. 229, § 102(a).
14. 106 P.L. 229, § 102(a)(2).
15. The exceptions in Section 103 include: (i) a statute, regulation, or other rule of law governing the creation and execution of wills, codicils, or testamentary trusts; (ii) a State statute, regulation, or other rule of law governing adoption, divorce, or other matters of family law; (iii) court orders or notices, or official court documents (including briefs, pleadings, and other writings) required to be executed in connection with court proceedings; (iv) any notice, the cancellation or termination of health insurance or benefits or life insurance benefits (excluding annuities).
16. 106 P.L. 229, § 101(c)(1). *See* also the Conference Committee Report emphasizing that the disclosure is required only in certain circumstances, “This means that if a consumer protection statute requires delivery of a paper copy of a disclosure or item to a consumer, then the consent and disclosure requirements of subsection (c)(1)(A-D) must

be satisfied. Otherwise, subsection (c) does not disturb existing law.”

17. 106 P.L. 229, § 101(c)(1)(A).
18. 106 P.L. 229, § 101(c)(1)(B)(i).
19. 106 P.L. 229, § 101(c)(1)(B)(ii).
20. 106 P.L. 229, § 101(c)(1)(B)(iii).
21. 106 P.L. 229, § 101(c)(1)(B)(iv).
22. 106 P.L. 229, § 101(c)(1)(C)(i).
23. 106 P.L. 229, § 101(c)(1)(C)(ii).
24. 106 P.L. 229, § 101(c)(1)(D)(i).
25. 106 P.L. 229, § 101(c)(1)(D)(ii).
26. 106 P.L. 229, § 101(c)(3).
27. 106 P.L. 229, § 101(h).
28. 106 P.L. 229, § 101(c)(2)(B).
29. 106 P.L. 229, § 101(e).
30. For example, “This Agreement and the documents and instruments referred to herein constitute the entire Agreement between the parties with respect to the matters herein addressed, and supersede and cancel all prior or contemporaneous agreements, representations, warranties, communications or understandings, whether oral or written.”
31. For example, “This Agreement may not be modified or amended except by a writing duly executed and delivered by the parties.”
32. For example, “No waiver of any provision of this Agreement shall be effective against a party unless in a writing duly executed and delivered by such party.”