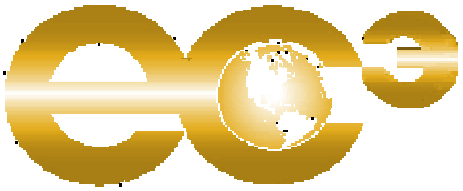
Record Retention Analysis Under E-Sign



Exposure Draft

A National Electronic Commerce Coordinating Council White Paper

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National Electronic Commerce Coordinating Council

The National Electronic Commerce Coordinating Council (**NECCC**) is an alliance of national state government associations dedicated to the advancement of electronic government within the states. The Council is comprised of the National Association of State Auditors, Comptrollers and Treasurers (**NASACT**), the National Association of State Chief Information Officers (**NASCIO**), the National Association of State Purchasing Officials (**NASPO**), and the National Association of Secretaries of State (**NASS**). In addition to these voting members, other governmental and private organizations participate in an advisory capacity. These associations include the Information Technology Association of America (**ITAA**), the National Automated Clearing House Association (**NACHA**), the National Association of Government Archives and Records Administrators (**NAGARA**), the National Association of State Chief Administrators (**NASCA**), the National Association of State Treasurers (**NAST**), and the National Governors Association (**NGA**). ITAA and NACHA represent private information technology companies and the financial services and technology industries.

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Introduction

On June 30, 2000, President Clinton signed the Electronic Signatures in Global and National Commerce Act (E-Sign).[1] E-Sign establishes a nationwide legal baseline for electronic signatures in commercial transactions in or affecting interstate or foreign commerce by providing for the validity of electronic signatures and records in such transactions. E-Sign's impact on state record retention laws and practices is limited to those laws, rules, or regulations that require private parties to retain records and contracts in transactions in or affecting interstate commerce.[2]

The scope of E-Sign is limited to signatures, contracts and records related to transactions in or affecting interstate commerce. E-Sign defines transaction as " an action or set of actions relating to the conduct of business, consumer or commercial affairs between any two or more persons." This is more restrictive than the traditional interpretation of commerce clause authority. E-Sign does not affect state filing requirements, or the record retention practices of state agencies. The definition of transaction restricts the impact of E-Sign to truly commercial transactions. E-Sign bars state agencies regulating commercial transactions from rejecting an electronic record created and retained by a private party on the ground that the record is electronic, not paper[3].

E-Sign record retention provisions allow state regulatory agencies to set performance standards for electronic records that law, rules or regulations require private entities to retain. This Paper is designed to explain E-Sign's impact on the authority of states to require that private parties retain written records of certain transactions. Key provisions of E-Sign follow.

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[1] 15 USC 7001 et seq, P.L. 106-229.

[2] This paper does not discuss issues related to the record retention practices of public agencies. The National Archives and Records Administration has published excellent guidance for agencies reviewing issues related to archiving electronic records. The citation for this document is in the resources section of this paper.

[3] E-Sign does not apply to government activities that are not commercial transactions in or affecting interstate or foreign commerce. Does this mean that such government activities as the standards for collection of wage and hour information and unemployment compensation taxes are not covered by E-Sign? Arguably they are not covered by E-Sign based on the definition of transaction. Taxation is a government activity, not a commercial activity. However, the question is whether the key to the transaction is the submission of the records to the unemployment compensation authority, or is it the payment of wages to the worker? The latter would be within the scope of E-Sign, while the former is not. In evaluating such transaction any electronic record related regulation should focus on the governmental activity in the record keeping and reporting requirement of the transaction, and not on the commercial component of the transaction.

I. Validity Of Electronic Signatures And Records.

Section 101 states the general rule that an electronic signature and contract or record is valid, provided it meets the other legal requirements of the transaction. 15 USC 7001(a). The scope of the provision is limited to commercial activity by the definition of transaction set forth in section 106(13). 15 USC 7006(13).

Section 101(a)(1) provides:

"(a) IN GENERAL -- Notwithstanding any statute, regulation, or other rule of law (other than this title and title II), 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, validity, or enforceability solely because an electronic signature or electronic record was used in its formation." 15 USC 7001(a).

Example: Acme Asbestos Abatement Company, a multi-state firm whose corporate headquarters are located in the state of Business land, is in the business of asbestos removal. Acme entered a six-year contract with Property Management, Inc., to remove asbestos from all of the multi-family housing managed by Property Management in the state of Freeland. The parties enter an electronic contract, signed electronically, and stored on duplicate diskettes held at each company's respective offices in Freeland. There is no paper copy of the contract or signature. Under E-SIGN, Freeland's state courts must treat the electronic contract and signature just as they would a paper contract[4].

Paragraph 101(b) of E-Sign provides that state law requirements, other than those mandating a paper record and signature, apply with equal force to electronic records and signatures, and that no person is obligated to do business electronically:

(b) PRESERVATION OF RIGHTS AND OBLIGATIONS -- This title does not --

(1) 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 non-electronic form*; or

(2) require any person to agree to use or accept electronic records or electronic signatures, *other than a governmental agency with respect to a record other than a contract to which it is a party.* 15 USC 7001(b), emphasis added.

[4] The examples are provided by the authors and are not part of the statute.

This provision does not require governments to use or accept electronic records for all documents relating to the formation of "a contract to which it is a party". Such an interpretation would be inconsistent with E-Sign's stated purpose of enabling, but not mandating, electronic transactions. OMB has interpreted §101(b)(2) to apply " to the entire transaction involving a government contract, including all records related to the contract"[5]. Accordingly, with respect to contracts and procurement, governments are treated in the same manner as any other party, encouraged, but not required, to use or accept electronic records in its transactions.

> *Example: In our hypothetical, the representative who signed the contract electronically on behalf of Property Management was the 12-year old son of the owner. Under Freeland state law, any contract signed by an individual under the age of 16 is voidable. Acme's contract with Property Management is voidable to the same extent that it would have been had it been on paper.*

Section 101(b)(2) contains a limited exception to the general rule that parties cannot be required to use or accept electronic records or electronic signatures. Government agencies are required to use and accept electronic records or signatures with respect to commercial transactions in or affecting interstate or foreign commerce, but are not required to use or use or accept electronic records or electronic signatures on contracts to which they are a party. The effect of this provision is that a government agency is not required to accept electronic records or signatures related to contracts entered with the government, in connection with government-to-government interaction, or in pure government non-commercial actions.

However, where private sector parties do business electronically, governments must accept the electronic signatures and records as evidence of the transaction between the parties, provided the record and the transaction meet other applicable statutory and regulatory requirements. Therefore, where a law, rule, or regulation requires private parties to retain records of commercial, financial, or banking transactions, government cannot deny the validity of a record *solely* because the record is electronic. E-Sign also bars government agencies from requiring that records be kept on paper, except in certain specified areas of governmental activities. This exception for records evidencing transactions between private parties does not however, limit the government's ability to specify standards and formats for filings with government entities.

> *Example: The State of Freeland's Department of Environmental Protection regulations require that asbestos abatement contractors keep copies of the asbestos abatement contracts into which they enter. All other things being equal, the inspectors from Freeland's Department of Environmental Protection who inspect Acme's Freeland office to ensure Acme's compliance with the state's asbestos law must find that Acme has satisfied the agency's contract retention regulation by keeping an electronic copy of its electronic contract with Property Management.*

[5] GUIDANCE ON IMPLEMENTNG THE ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT (E-SIGN) Office of Management and Budget Memorandum M-00-15.

One practical effect of these two provisions is that government agencies must be prepared to honor the validity of some electronic transactions and records. Individuals and businesses may choose to do their electronic business through wide variety of hardware and software systems and formats. Therefore, agencies performing audit or investigation functions will be faced with reviewing records of electronic transactions maintained in a variety of formats. E-Sign addresses this issue in three ways: (1) §103 exempts some records from the general rule of validity for electronic signatures and records; (2) §101(d) E-Sign provides that an electronic record may be denied validity if it does not remain accurate and accessible to all persons entitled to access the record; and (3) §104 allows agencies to impose performance standards to ensure the accuracy, integrity, and accessibility of records.

II. Specific Exceptions to Validity

Section 103 of E-Sign exempts the following records from the general rule of validity stated in §101(a):

- Records governed by laws governing wills, codicils, and testamentary trusts;
- Records governed by laws governing adoption, divorce and family law;
- Much of the Uniform Commercial Code;
- Court orders or notices, or official court documents (including briefs, pleadings, and other writings) required to be executed in connection with court proceedings;
- Notices of utility termination;
- Notices of default, acceleration, foreclosure, evictions, etc, related to a primary residence;
- Notices of cancellation or termination of health insurance or benefits or life insurance benefits (excluding annuities);
- Notices of product recall; and
- Records required to accompany transportation and handling of hazardous, toxic and dangerous materials.
- 15 USC 7003(a) and (b)

State law, not E-Sign, governs the validity of electronic signatures and records in these subject matter areas.

> *Example: Freeland state law requires that the hazardous waste disposal company that carts away the asbestos-containing material that Acme disposes of at the asbestos abatement site keep a written log in their truck stating the source, amount, and condition of the asbestos debris that they are transporting. E-SIGN does not prohibit states from imposing the requirement of a written record in such circumstances.*

III. Accuracy and Accessibility

Section 101(d)(1) provides that where a statute, regulation or rule of law requires that a contract or record in a transaction in or affecting interstate or foreign commerce be retained, an electronic record only meets the statutory requirement if:

- The record is accurate;
- The record is accessible in a form that can be accurately reproduced; and
- The record is accessible to all persons entitled to review the record.

Subparagraph (3) of §101(d) provides that records meeting the requirements of subparagraph (1) of §101(d) meet legal requirements for original documents. 15 USC 7001(d).

> *Example: In our hypothetical, in the process of storing the electronic contract on the duplicate diskettes held by each party to the contract, Acme's chief information officer accidentally alters the text of the contract by deleting the addresses of the properties that Acme is required to abate. E-SIGN permits the Department of Environmental Protection to find that, because the files created on the diskettes do not accurately represent the terms of the agreement between the parties, they do not meet the Department's requirement that Acme retain a copy of its abatement contracts.*

Section 101(e) provides that a record required to be retained that is kept electronically may be denied validity if the 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." *Emphasis added.*

Section 101(d) allows agencies and individuals to challenge the validity of an electronic contract or record on the basis that is not kept in a format that is accessible and capable of accurate reproduction. E-Sign does not automatically invalidate contracts and records that do not meet the requirements of §101(d) and (e), but rather, allows parties to raise the question of whether the electronic record is adequate evidence of the transaction.

Section 101(d) does not address the question of whether the record is retained in a format that would either bar or disclose attempts at alteration of the record. Record integrity differs from record accuracy in that an unaltered record may be retrieved accurately at any time until the record is altered. A record integrity requirement would impose restrictions designed to prevent or disclose alteration and to ensure accurate retrieval over an extended period of time. Absent record integrity requirements, a record might actually be an accurate representation of the contract or original record, but might carry little evidence to support the assertion that the record had not been altered. E-Sign recognizes the importance of record integrity, and specifically allows agencies to set performance standards to ensure record integrity.

IV. Performance Standards

Section 104 authorizes state regulatory agencies to[6] adopt performance standards to ensure the accuracy, accessibility and integrity of records kept by entities outside of government. The preservation of rulemaking authority, and where authorized by statute, the issuance of orders or guidance, limits the preemptive effect of E-Sign. This rulemaking authority is limited to cases in which retention of the contract or related records by private parties is required by regulation, order or guidance. E-Sign addresses these issues in terms of right to exercise existing rulemaking authority to "interpret" §101(d) of the E-Sign law.[7]

> *Example: In our hypothetical, the state of Freeland's Department of Environmental Protection has authority, under its enabling legislation, to promulgate regulations requiring that asbestos abatement contractors working in the state keep copies of the contracts that they enter. E-SIGN permits the Department to promulgate regulations requiring companies like Acme using electronic records to meet the agency's records retention requirement, and adopt and enforce security policies for the information technology resources on which such contracts and signatures are stored.*

E-Sign imposes technological neutrality through a provision requiring that the method used to ensure accuracy, integrity and accessibility not ". . . require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating storing, generating, communicating or authenticating electronic records or electronic signatures."
§ 104(b)(2)(C)(iii) of E-Sign,15 USC 7004(b)(2)(C)(iii).

> *Example: In our hypothetical, E-SIGN would prohibit the State of Freeland's Department of Environmental Protection from attempting to ensure that as many tenants as possible had access to copies of Acme's contracts by issuing regulations requiring that electronic versions of such contracts be stored on Microsoft Word. However, E-Sign would not prohibit the State of Freeland's Department of Environmental Protection from issuing regulations that required the use of widely available word processing software without specifying the brand*

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[6] E-Sign allows a federal regulatory agency, or a state regulatory agency to interpret §101(d). " The act defines federal regulatory agency, but does not define state regulatory agency. A federal regulatory agency includes: "any executive department, military department, Government corporation, Government controlled corporation, or other establishment in the executive branch of the Government
(including the Executive Office of the President), or any independent regulatory agency." 5 USC §552(f). In the absence of definition of state regulatory agency, states should implement E-Sign using a broad definition approximately parallel to the federal regulatory agency definition. It is not clear if or how this section of E-Sign applies to other state entities such as local governments.

[7] §104(b)(1) seems to limit the authority to interpret section 101 of E-Sign to those circumstances in which a state or federal agency has and is using rulemaking authority under a specific statute impacted by E-Sign. It is not clear if this §104(b) rulemaking authority related to E-Sign is available when an agency is adopting rules under a general grant of authority such as those typically found in an agency enabling act.

because this is consistent with ensuring the accuracy, integrity and accessibility of the electronic record.

In addition, the agency adopting electronic record regulations must show:

- That the rule is consistent with §101 of E-Sign;
- That there is substantial justification for the rule;
- The methods selected are substantially equivalent to the requirements imposed on non-electronic methods;
- The methods do not impose unreasonable costs on the acceptance and use of electronic records; and
- The methods do not add to the requirements of §101 of E-Sign. 15 USC 7004 (b)(2)(C).

These requirements, although focusing on electronic records, are similar to analysis that agencies in many states currently undertake in promulgating regulations under their enabling legislation. Section 104(b)(2)(C)(ii) of E-Sign, 15 USC 7004(b)(2)(C)(ii), requires that performance standards be (I) "substantially equivalent to the requirements imposed on records that are not electronic records", and (II) that the standards not impose "unreasonable costs on the acceptance and use of electronic records". The "unreasonable cost" qualification applies only to the "acceptance and use of electronic records", and does not impose a comparison to the non-electronic processes. Therefore, the concept of "unreasonable cost" should be analyzed using a broader set of references than merely the comparative cost of the non-electronic process. OMB suggests that a cost benefit analysis is an appropriate component of assessing whether performance standards impose "unreasonable costs."[8]

Section 104(b)(3) of E-Sign allows an agency to impose a specific technology in spite of §104(b)(2)(C)(iii) when the requirement: (1) serves an important governmental objective; and (2) is substantially related to the achievement of that objective.15 USC 7004(b)(3). However, §104(b)(3) does not allow agencies to specify a brand of software or hardware. The Federal Office of Management and Budget has taken the position that "this provision is probably best read to mean that agencies may not require the use of the hardware or software of a specific manufacturer, not that they may not set performance standards for hardware and software". OMB at 13. Moreover, it is important to note that the standard for imposition of specific technology is fairly low. For example, it is likely that the need to safeguard sensitive information about individuals in the hands of private enterprise or government is a sufficiently important government objective to justify imposition of a technology specific record retention performance standard.

Under §104(b)(3)(B) agencies may only require a paper or printed form through new rules when there is a compelling government interest related to national security or law

[8] OMB at 10

enforcement. The law enforcement exception could be reasonably interpreted to apply to any statutory or regulatory provision with a criminal sanction.

Section 104(b)(4) provides that the technology neutrality provisions under §104(b)(2)(c)(iii) do not apply to government actions related to procurement. Other provisions of section 104(b) still apply to government action to impose performance standards related to procurement. Government agencies are on equal footing with private enterprise under E-Sign. Government retains the ability to choose when and how it will do business electronically.

V. Effective Date

The general validity provisions of §101 took effect on October 1, 2000. Where a rule of law requires private parties to retain a contract or related record, the act took effect on March 1, 2001. With regard to required records, agencies were able to delay the effect of E-Sign to June 1, 2001 by announcing, initiating, or proposing intent to engage in rulemaking to interpret E-Sign.[9] This delayed effective date only applied to records subject to the rules the agency had announced the intention to issue or amend.

Agencies could undertake the following steps to implement this provision:

1. Review and evaluate all existing record retention requirements, regardless of whether they are in statute, regulations, policies, circular letters, or any other agency pronouncement;
2. Evaluate the agency's ability to review and analyze electronic records of regulated parties and others with respect to the agency's mission;
3. Reach out to regulated parties to discuss electronic record formats that are compatible with both the agency's needs and concerns, as well as those of the regulated parties; and,
4. As needed, announce, propose or initiate electronic record retention performance standards.

VI. Suggested Agency Action

Agencies must understand that as time goes on a growing percentage of their regulated entities will be conducting some or all business electronically. This means that agencies will be in the position of reviewing electronic records to determine whether entities are in compliance with record keeping and other regulatory requirements. This also means that in many cases, agencies will create or come into possession of electronic records that must be archived. With respect to E-Sign agencies should begin by reviewing the record keeping requirements they impose on private entities as follows:

[9] 15 USC 7007(b)

1. Is there still a need for the record retention requirement, and is the retention period appropriate to the business need for retention? While these are not strictly E-Sign issues, these are valid questions upon which to begin the overall analysis with respect to a given record

2. Does the record relate to a transaction in or affecting interstate or foreign commerce under E-Sign?[10]

3. Is there a specific E-Sign exception that removes the record from the scope of E-Sign?[11]

4. For records affected by E-Sign: Is regulation of the record retention format needed, and what level of regulation is needed?[12] These are risk analysis questions. For some kinds of record, it may be appropriate to allow the record to be kept in any format, so long as it can be produced in a manner accessible by the agency. For other records, the public interest may demand a higher level of regulation to ensure the integrity of the record.

    a. These issues will determine both what level of performance standard is appropriate, and what kind of performance standard is acceptable under E-Sign.

    b. A technology specific performance standard is only appropriate under E-Sign if the standard is substantially related to the achievement of an important government objective.

5. If an agency develops performance standard regulations, do those regulations meet the requirements of section 104(b) of E-Sign?

    a. Is the rule consistent with E-Sign?
    b. Is there substantial justification for the rule?
    c. Are methods substantially equivalent to non-electronic records?
    d. Do they impose substantial cost of the use of electronic records?

6. If an agency develops performance standard regulations, do the regulations and the adoption process comply with the state regulatory process requirements, especially as those requirements relate to the imposition of requirements on business?

Any analysis of the implementation of electronic records should not be limited merely to complying with E-Sign because it covers only a small portion of government records. The same risk factors that should be assessed in addressing record retention by private parties play a large role in decisions about agency record management and retention.

[10] See section 1: Validity of Electronic Signatures and Records.
[11] Section 2: Specific Exceptions to Validity.
[12] Section 3 and 4: Accuracy and Accessibility, and Performance Standards.

The analysis should be conducted in the broader perspective of the overall implementation and use of electronic records in transactions by and with government because both technology and public policy support the use of electronic records in such transactions.

VII. Resources

Most of these resources are intended for use by federal agencies. However, they all contain useful comments and analysis of E-Sign, and useful information for state agencies.

1. The National Archives and Records Administration has published a useful guide for federal agencies. The NARA document, entitled "Records Management Guidance for Agencies Implementing Electronic Signature Technologies" is available at: http://www.nara.gov/records/. This document provides useful examples of the considerations important to creating effective performance standards.

2. The Department of Justice has published a document entitled Legal Considerations in Designing and Implementing Electronic Processes: A Guide for Federal Agencies. This document is available at: http://www.usdoj.gov/criminal/cybercrime/eprocess.htm

3. Treasury Department has also published guidelines at: http://www.fms.treas.gov/eauth/index.html

4. OMB has published guidance available at: http://www.whitehouse.gov/omb/memoranda/m00-15.html

5. The National Governor's Association has published a guide called: "What Governors Need to Know About E-SIGN: The Federal Law Authorizing Electronic Signatures and Records." This document is available at: http://www.nga.org/center/divisions/1,1188,C_ISSUE_BRIEF^D_369,00.html

6. The National Institute of Standards has published a guide entitled: "Introduction to Public Key Technology and the Federal PKI Infrastructure." This document is designed to assist agencies in selecting appropriate technology, and is available at: http://csrc.nist.gov/publications/drafts/pki-draft

7. Electronic Signatures and Records: The New US Perspective. Raymond T. Nimmer, Computer and Internet Lawyer, December 2000. Aspen Law and Business. 2000