

Paperless Promises to Pay: Legal Issues Impacting E-notes

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Introduction

Technology continues to be a trending topic in the timeshare industry—a large part of this trend is replacing printed materials with digital ones. Just look at Marge Lennon’s article in the July 2016 issue of *Developments*: downloads from the ARDA World app are replacing 100-page programs, tablets are replacing in-room binders in resort rooms, and USB drives containing required legal documents for consumers are replacing printed materials.

Digital advancements are not limited to how we receive information—they also impact how we make contracts. Timeshare developers are applying this trend to the consumer purchasing experience through electronic documents and signatures—commonly known as “e-Contracting.” The benefits companies seek through e-Contracting include:

- Accelerating contract processing, review and approval times;
- Saving on printing and shipping costs; and
- Reducing potential for human error.

Realizing these benefits requires attention to the laws and challenges unique to e-Contracting. While some of these issues apply to all types of consumer documents, special issues relate specifically to electronic promissory notes, or “e-Notes.”

E-contracting—Legal Framework

In the United States, e-Contracting is governed by both federal and state laws. The applicable federal law is the Electronic Signatures in Global and National Commerce Act (the E-SIGN Act). The E-SIGN Act sets a federal “floor” of baseline rights and requirements for e-Contracting. The core of the E-SIGN Act is that electronic signatures and records will not be denied legal validity just because they are only available in electronic form.

At the state law level, the Uniform Electronic Transactions Act (UETA) is a model law that establishes this same core principle. The only states that have not yet adopted the UETA in some form are Washington, Illinois, and New York. As a general matter, the E-SIGN Act preempts or “trumps” state laws, but a special “savings clause” in the E-SIGN Act allows states to be governed by the UETA (as long as it does not conflict with the E-SIGN Act).

One of the E-SIGN Act's key requirements is that timeshare consumers must be provided specific disclosures before they consent to e-Contracting, including their right to:

- Use paper documents instead of electronic ones;
- Withdraw their consent to e-Contracting; and
- Request paper copies of electronic documents.

If consumers provide consent electronically, it must be in a manner that “reasonably demonstrates” the consumer can access the information being disclosed to them. This means that a consumer must have access to a tablet, smartphone or computer to enable his or her review of the electronic document package.

The UETA also provides important guidelines for electronic signatures in consumer transactions. For example, an electronic signature must be “attributable” to a consumer to be enforceable against them. Thus, a timeshare developer's e-Contracting system must be secure and provide for unique signatures so documents can only be read and signed by designated consumers. A good system also needs to create a rigorous audit trail so the e-Contracting process can be monitored and established every step of the way.

E-notes: Special Challenges

Consumer promissory notes—and their use by timeshare developers to obtain financing—are an essential part of the vacation ownership industry.

Because paper promissory notes are “negotiable instruments” under the Uniform Commercial Code, having “possession” of the “original” signed note is legally significant. Under commercial law, physical possession is how a lender “perfects” a security interest in a note pledged as collateral, and enables the lender the right to enforce the note against the timeshare borrower.

With e-Notes, however, the central concept of “possessing” an “original” note under commercial law does not work the same way. To illustrate this, imagine a timeshare developer has the “original” PDF file of an e-Note and wants to pledge it as collateral to a lender in a securitization. If the timeshare developer e-mailed the lender the PDF as an attachment in an effort to give the lender physical “possession” of the e-Note, that would just create a duplicate PDF of the note—it would not transfer “possession” of an “original.”

To address this “problem of originals,” the E-SIGN Act and UETA have special rules for e-Notes. If complied with, these special rules allow for e-Notes to become “transferable records,” which can be transferred and assigned similar to negotiable instruments. Under these rules, a person with “control” of the transferable record has the same legal rights as a person who has physical possession of a traditional paper note.

To reliably create, maintain, and transfer “control” of e-Notes as transferable records, a timeshare developer's e-Contracting system must be highly sophisticated. Among other things, the e-Contracting system must:

- Maintain a single authoritative copy of each e-Note;
- Label the authoritative copy to identify the person in control;

- Provide the person in control with exclusive control of the authoritative copy; and
- Track and label non-authoritative copies of each e-Note.

An emerging digital trend in the timeshare industry is the use of e-Contracting systems that include secure “electronic vaults” of authoritative copies of e-Notes and related consumer documents. Once an e-Note is created and deposited in a timeshare developer’s electronic vault, the e-Contracting system is designed to enable the timeshare developer to then transfer control of the authoritative copies of the e-Notes to a separate electronic vault of a lender or its designated custodian as a part of its financing structure.

Establish Systems to Preserve Collateral

Capturing the benefits of e-Contracting efficiencies requires having systems in place that comply with the legal framework applicable to electronic transactions—particularly the E-SIGN Act and UETA. It is critically important to consult with legal advisors and electronic service providers prior to converting from traditional paper notes to e-Notes. Developers must adopt proper protocols to qualify the systems for the legal opinions required by lenders.

Given the advantages for both consumers and timeshare developers, use of electronic timeshare documents will continue to increase. Just as we’ve become more comfortable over time with conversion of other functions, such as mail, from manual to digital, getting a solid legal footing for e-Contracting and e-Notes will allow both consumers and timeshare companies to reap the benefits without additional risk.

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