The effective formation of contracts by electronic means

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1. Introduction

People have been forming contracts by electronic means for many years. In the past, the majority of electronic contracts were made in the context of Electronic Data Interchange, or EDI, which large corporations have traditionally used to transact through closed proprietary networks, using value added networks. This linking of suppliers with retailers, for example, simplified the parties' trading arrangements and reduced paperwork. EDI has had a particularly trouble-free existence but is usually limited to parties with continuing relationships.

In recent years, however, the focus has shifted away from EDI, and moved towards electronic contracts concluded by email or over the internet between parties with no previous relationship. The astronomical growth of the internet as a means of effecting transactions electronically has brought concerns and challenges for suppliers of goods or services, consumers and lawyers alike. The term 'e-commerce' we take to mean 'effecting commercial transactions by electronic means', and in particular over the internet, which is now a familiar concept to an enormous number of people. Governments world-wide are citing e-commerce as the next big thing and spending a great deal of time, money and energy to address the problems, both technical and legal, that it raises.

From a technical perspective, the major challenge is to overcome the significant security risks inherent in using an open network such as the internet to transfer sensitive information such as credit card details between unrelated parties. On one hand, it is of paramount importance that the supplier of goods or services is able to verify the identity of the purchaser, for example, for reasons of consumer protection or where the transaction involves illegal or regulated activity. On the other hand, the purchaser of goods or services needs to be sure that the integrity of the message sent is preserved, and received by the supplier without outside interference. From a legal perspective, the major challenge is in applying the traditional contract law framework to a relatively new, paperless method of contracting that can and often does, cross borders and different jurisdictions.

The purpose of this paper is to explore how established contractual principles can apply to the formation of contracts by electronic means. For example, how, where and when is the contract actually made in cyberspace and how can a party ensure that the law of a particular jurisdiction applies to the contract? This paper will address some areas of particular importance in online trading situations, for example, the issue of how a party has notice of the terms of an electronic contract and particular evidentiary problems raised by contracting by electronic means. The paper concludes with a brief look at the role of arbitration and alternative dispute resolution as a means of resolving e-commerce disputes.

2. Contract law principles applied to e-commerce

As we all know, a contract is an agreement between two or more people or organisations that will be enforced by the law. For an enforceable contract to arise, the law requires five elements to be present: there must be an offer setting out the terms of the contract; an unequivocal acceptance of the offer must be communicated to the offeror; the contract must be supported by consideration; the parties must have intended to create legal relations; and all parties must have the legal capacity to effect the transaction.

All this is no doubt well-trodden ground for legal practitioners, but the question arises, does this established framework operate in a paperless global context? For companies involved in conducting business online, an understanding of the process by which electronic contracts are formed is vital if transactions are to be upheld as enforceable contracts. If companies are serious in wanting to conduct online business, they should be advised as to how the above elements of a contract are established in the context of online transactions.

Offer

In making an offer, the offeror is expressing their desire to enter into an agreement based on certain terms, which, if accepted, will be legally binding. An offer can be made by almost any means of communication, from a telephone conversation to an email. An important preliminary point to note in the context of electronic offers is that the appearance of an offer is more important than the intent - it depends how a reasonable person would interpret the 'offer'. A web page's content or the wording of someone's email can easily constitute an offer, whether or not it was intended to be one, which can result in a binding contract with anyone who accepts.

There is, however, a fine line which divides an offer from an invitation to treat. An invitation to treat is merely like an advertisement for something, as opposed to an offer to enter into a contract, and any online merchant wishing to avoid unwanted contracts should stay safely on the side of

invitations to treat. Established cases have decided that displaying goods in a shop window with prices displayed is an invitation to treat: it is the customer who approaches the counter with the goods that makes the offer. In respect of displaying goods on a website, it is reasonable to draw the conclusion that this is only an invitation to treat (although no cases have decided this). In any event, online retailers should include in their websites disclaimers which classify the web pages themselves as invitations to treat.

Acceptance

In an 'everyday' situation, once an offer has been made, either orally or in writing, the offeree accepts it, again orally or in writing, and thus creates a contract. But in an online transaction, the parties may be thousands of miles apart, and in different time zones. If we assume that that an email sent out by the retailer, or the retailer's website itself, constitutes the invitation to treat, and it is the consumer that makes the offer, the moment of contract creation is the instant of acceptance by the offeree (the retailer). The following questions therefore arise; if the retailer then accepts the offer, how, where and when is the contract actually created? This is important for the purposes of determining the choice of law and jurisdiction which applies to the contract.

Historically, two rules have been developed by the courts to determine the moment of formation of contracts made by post and by facsimile/telex - the postal rule and the receipt rule. Under the postal rule, the contract is created the moment the letter accepting the offer is posted, irrespective of the fact that the offeror has not yet been notified of the acceptance. The receipt rule applies to situations of continuous communication between the parties, either on the telephone or using a fax machine. Under this rule, the contract is only created when the acceptance is communicated to the offeror.

It must therefore be determined which rule applies to contracts which are formed onine, whether by email or using the internet. Email may, at first glance, seem to fall under the postal rule, primarily as it is unusual for the sender of the message to receive instant feedback concerning its delivery, and the sender has no control over the message once sent. However, there are also reasons why email acceptance could fall within the receipt rule. Emails can be lost in the ether of cyberspace, and even if they arrive, they may have been corrupted en route. Given this, it may be unreasonable to conclude that a contract is formed the moment an email is sent. No cases have yet addressed the question of email acceptances. In respect of contracts made over the world wide web, which allows real-time instantaneous communication, as the sender has instant feedback, it is reasonable for the receipt rule to apply.

Given the fact that the retailer's acceptance does not create a contract until received by the customer under the receipt rule, the contract may well be formed in the customer's own jurisdiction. This is unsatisfactory for the merchant, who, in the event of a dispute with the customer, may have to issue proceedings in a foreign court. It is, however, open to the retailer, to specify in its standard terms and conditions that acceptance is effective once sent. The merchant thus seeks to ensure that the postal rule applies to the contract, which would be formed in the retailer's own jurisdiction. As a back up, the standard terms and conditions would also contain choice of law and jurisdiction provisions suitable to the retailer.

Consideration

Consideration is the something of value which converts a mere agreement into a legally enforceable contract. In the context of a commercial transaction, consideration is the money paid over by the purchaser and the goods delivered by the vendor. The requirement of consideration poses no threat to the validity of online contracts under which goods and money are likely to be exchanged, just like under a written contact.

However, there has been some doubt expressed as to whether 'click-wrap' agreements have any consideration. These are agreements whereby a customer agrees to certain terms and conditions (by 'clicking' a button on a web page) before being delivered certain digitised services such as shareware. It seems probable, however, that a court would consider that such free software was a benefit and therefore consideration.

Intention to create legal relations

Again, this requirement of a contract is fairly easy to satisfy in an online situation. Intention to create legal relations is presumed in a commercial environment (although this presumption can be rebutted). However, to avoid the possibility of a court refusing to allow an online merchant to ask for payment for digitised services it had delivered on the basis that a customer did not intend to create legal relations, the customer should be made to go through a series of steps which preclude any alternative argument.

Capacity

The fifth requirement of a legally binding contract is that all parties must have the legal capacity to enter into the contract. From the retailer's point of view, the risk is that they may find themselves with an unenforceable contract made with a minor. The capacity of a party to effect a transaction can be very difficult to determine when the parties are not dealing face to face. For this reason, identity (and role) certification, which is dealt with later, is of crucial importance.

3. Areas of particular importance in online trading situations

Illegal or regulated activity

As stated earlier, it is often of paramount importance for the online retailer to verify the identity of the customer with which it is dealing. The fact that the parties to an electronic transaction are dealing remotely makes it extremely difficult for the retailer to know the customer. Although new technologies such as digital certificates may become widely-used enough to provide comfort to retailers, in the meantime, online businesses may have to resort

to blocking access to their website from undesirable jurisdictions.

This may be necessary for various reasons. Perhaps the most important, however, is that certain types of activity when conducted online, such as providing financial services, gaming and wagering or adult material, might be illegal or subject to heavy regulation in certain countries. Fortunately for providers of such services or material, many jurisdictions will not seek to enforce their laws and regulations against the owners of websites unless there is some evidence that the site is directed at that particular jurisdiction. The important lesson then for online businesses in these areas is that every care should be taken not to 'direct' their website at countries that might not appreciate it, and they should even consider blocking access to the site for users from certain jurisdictions. The consequences of carelessness or disregard for such foreign laws and regulations for website owners are potential civil liability and criminal sanctions.

Online terms and conditions

In the majority of B2C[1] scenarios, the consumer will have little or no scope to negotiate the terms of the contract. Instead, the retailer will expect the purchaser to contract according to its standard terms and conditions of trade, which will be displayed on its website. However, under general contract law, such standard terms and conditions will only take effect if the customer is given notice of them before the contract comes into existence. This raises the question, how can an online merchant ensure that it gives the customer sufficient notice of its standard terms and conditions?

There are essentially three different ways of alerting the browsing customer to a merchant's terms and conditions. The first, which gives the least notice of the terms and conditions, is merely a statement that the contract is subject to the retailer's standard terms and conditions, without stating whether they can be found on the website, and if so, where. This, however, may not provide sufficient notice to the consumer of the terms of the contract. The second technique is to include with the above statement a hyperlink to the terms and conditions themselves. As the retailer is effectively inviting the customer to go along and inspect the terms of the contract, this might satisfy the notice requirement. The third method, which has the greatest effect of all, and is of most use where the terms and conditions are unusual or more onerous than most, is to incorporate a dialogue box in the web page which actually contains the terms and conditions themselves in full. The customer is then given the options of clicking on "I agree" or "I decline" buttons on the web page. This is a powerful method of alerting the customer, who has been forced to read, or at least scroll through, the terms and conditions, and cannot conclude the transaction unless they agree to them.

'Battle of the forms'

In the rather different situation of two companies negotiating the terms of a contract using email, is a contract actually created if each side seeks to impose its own set of standard terms and conditions on the other? This scenario has been termed the 'battle of the forms', and can apply in an online situation as in any other.

On a strict interpretation of contract law, no contract is formed if each email containing conflicting standard terms is a counter-offer which rejects and extinguishes the original offer. There are two different approaches to the scenario of the 'battle of the forms'. Under one approach, which was put forward by Lord Denning M.R. in *Butler Machine Tool Co v Ex-Cell-O Corporation* [1979] 1 WLR 401, as the parties are in agreement on all the principal points, such as the product being sold, the price and the quantity, the contract is deemed to have been created, and the differing terms and conditions should be read together and reconciled if possible. Under the other approach, such as that found in the *Uniform Laws on International Sales Act* 1967 [UK], if the email which purports to accept the offer contains differing standard terms, but these terms do not materially alter the agreement, the offeror is taken to accept the offeree's terms unless he promptly objects to the discrepancy.

Companies negotiating in this way should therefore object to the other party's standard terms and conditions received by email and ensure that they do not take any action which could be construed as acceptance of the other party's terms and conditions. Any acknowledgment of the acceptance of their offer could result in them being bound to the other party's standard terms and conditions.

4. Evidentiary problems

In the majority of electronic transactions, the only evidence of the agreement will be computer-generated documents relating to the transaction. This creates a problem: it is not difficult to amend data which is stored on a computer. The risk to the parties in an e-commerce transaction is that a third party could amend or even remove such data without being detected. This is a serious concern from an evidentiary point of view. The parties to an electronic contract need to know that all the information which has been stored on computer relating to the contract is secure. In other words, if the integrity of the computer-generated record of the transaction cannot be guaranteed, its evidential value as a record of the contract can be greatly diminished.

One solution to the above problem is the use of digital signature technology to establish that the integrity of the electronic document has been maintained and therefore preserve its evidential value. A digital signature is the transformation of a document or message using cryptography. Without getting into the mechanics of cryptography, digital signatures not only verify the contents of a message and the identity of the signatory, but also allow a party to check that the document was in fact sent by that particular person. If any aspect of the digitally-signed document or message is changed, the verification process will ascertain either that the document has changed since being digitally-signed, or that it was not signed by the purported signatory. In the event of the record being tendered in a dispute, its value as evidence would be discounted by the court.

One final note of caution, however, is that technology advances at an incredible rate, and it is highly conceivable that a digital signature over time may itself become insecure. The result of this would be that even a digitally-signed document, which has not been interfered or tampered with, would not be guaranteed to have a high evidentiary value in court. Any procedure in place for archiving electronic records therefore needs to be updated as and when technology develops, and digitally-signed documents should be re-signed at the necessary intervals. Similarly, companies may have to replace their signing and encryption keys on a number of occasions and for different reasons. Various codes of practice exist to provide guidance on information security management, which can assist companies wishing to review their information security arrangements.

5. Role of ADR in e-commerce disputes

Disputes are just as likely to arise in contractual relationships established by electronic means as by any other means. As everybody knows, even if the sums involved are significant, if the dispute develops into litigation, the costs of pursuing or defending proceedings can quickly overtake the value of the claim itself.

As an alternative, when an e-commerce dispute does arise, the parties could themselves choose to refer their dispute to arbitration or mediation. This would enable the parties to select a referee able and willing to determine complex issues of information technology and law, and also to attempt to resolve the dispute without spending a great deal of time and money doing so. Such arbitration was used successfully in respect of Y2K disputes involving very significant sums of money. It remains to be seen whether a niche practice of e-commerce arbitrators and mediators will develop in time.

Alternative Dispute Resolution, or ADR, may also have a big part to play in our digital future. It has been argued by E C Lide, in his 1996 paper [2], that ADR will play a very important role in addressing the new issues which arise from using the internet to conclude commercial transactions.

The type of online ADR system which Lide suggests is somewhere between an adjudicatory model and a forum for the enforcement of one legal system or another. The most obvious advantage of having an internet ADR forum is that the ADR could be conducted online, thus removing the need for the parties involved to have to litigate in other jurisdictions. Experts in e-commerce could also be used as arbitrators in the ADR. This model works well for the ICANN Uniform Domain Name Dispute Resolution Policy.

6. Conclusion

The world of electronic formation of contracts, and using the internet as a medium for concluding commercial contracts, is a very exciting place which will only assume an increasing importance in all levels of society. It does, however, present new challenges to which anyone involved in electronic contracts must rise. I believe that accepted principles of contract law are flexible enough to cope with the digital age, and with the right degree of care and caution, we can make the most out of the opportunities e-commerce presents.

The key to the future is lawyers who understand the technology so that long standing and robust legal principles can be properly applied in the resolution of legal disputes.

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* This paper is based on a presentation for IIR E-commerce Contracts Seminar, 30 July 2001

1 Business-to-Consumer

2 Lide, E. Casey. "ADR and Cyberspace: The Role of Alternative Dispute Resolution in Online Commerce, Intellectual Property and Defamation." *Ohio State Journal on Dispute Resolution* 12 (1996): 192-222.