

# **BOOK REVIEW**

## **PREPARING FOR EDI**

**EDI AND AMERICAN LAW: A PRACTICAL GUIDE**

By Benjamin Wright, J.D.

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Electronic Data Interchange (EDI) allows businesses to conduct their transactions through computer networks and eliminates the need for companies to physically exchange paper forms and documents. Using EDI, companies can conduct instantaneous transactions without waiting for standardized documents, such as quotations, purchase orders, and invoices to be delivered by mail. In a conventional paper system, the data contained in these documents would typically be input into the receiving company's computer system manually, thus introducing additional delay and greater potential for error. EDI promotes efficient use of computer resources by eliminating the need for the receiving company to re-enter the data received.

In its basic form, EDI requires an agreement between trading partners that dictates a standard data format for their computer to computer communications so that each party can encode and decode any information in a transaction. The two trading partners need not have a direct connection between their computer systems. Instead, many companies hire third party network providers which serve as clearinghouses for messages between the parties. By joining a third party network, the company has access to any other company on the network and may even have access to companies using other third party networks. The networks also provide additional services to EDI users, such as password security for their accounts, regular backups of data sent over the networks, and audit trails.

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EDI is rapidly changing the manner in which business transactions occur. While this technology increases speed and efficiency in the business world, it also presents legal questions which are easily overlooked by parties using EDI. Some of these questions can be answered by the application of existing legal doctrine, but many questions will require fresh answers from the legal system. *EDI and American Law* provides an invaluable overview of the potential legal problems for anyone currently involved in EDI transactions. The author, Benjamin Wright, expects neither legal expertise nor technical exposure to EDI from his readers, which makes the book accessible to anyone involved or interested in EDI. By reading the 100 pages of concise text now, EDI users may save their companies from litigation later. *EDI and American Law* should be required reading for managers responsible for implementing EDI, lawyers who provide legal advice to these managers, and government officials who will now be responsible for designing new recordkeeping and audit regulations that are not incompatible with EDI.

Since there exists little caselaw or statutory authority to guide companies using EDI, the best precaution is to understand the risks and to allocate these risks fairly in contracts between trading partners, network providers, and any other parties affected by the implementation of EDI. *EDI and American Law* addresses this need on three levels. First, it alerts companies using EDI to pitfalls they are likely to overlook. Second, it serves as a guide in negotiating agreements with trading partners and network providers. Finally, it raises important issues which both industry partners and the legal community must address to avoid unnecessary and extensive litigation.

## TRADING PARTNER AGREEMENTS

Well-drawn trading partner agreements can prevent disputes by settling legal questions in advance. In a traditional paper trading system, the Statute of Frauds and related doctrines prescribe that certain contracts will only be enforceable when supported by "written" and "signed" evidence.<sup>1</sup> When trading parties conduct their transactions through EDI, no such evidence exists in its conventional sense. Mr. Wright notes that some trading partner agreements attempt to establish that the Statute of Frauds will not apply to their EDI transactions. While the enforceability of such a provision has not been tested in court, Mr. Wright questions whether simply waiving the Statute of Frauds will be effective. Instead, he argues that since the requirements of writing and signing are designed to ensure that a contract is supported by reliable (written) evidence and

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1. U.C.C. § 2-201 (1989).

that the parties assented to (signed) the contract, the trading partner agreement must establish electronic equivalents to writing and signing. One of the strengths of *EDI and American Law* is that Mr. Wright includes sample clauses to show how his concepts can be built into an EDI trading agreement.

Mr. Wright's approach to the writing and signing requirements is illustrative of his approach to problems throughout the book. Before presenting sample clauses intended to address the issue, Mr. Wright warns, "while the author considers this a sound technique for many EDI applications, its effectiveness cannot be guaranteed. No legislature or court has approved it."<sup>2</sup> Such disclaimers do not detract from the value of the book. Until legislatures develop definitive rules for EDI agreements, no model provisions can eliminate all risk that EDI will raise problems in litigation. Nonetheless, Mr. Wright's samples provide an invaluable starting point for EDI managers to negotiate agreements and to make their trading partners alert to potential problems. Courts may be more sympathetic to enforcing trading partner agreements that articulate carefully formulated standards for computer communications. For example, if the agreement specifies that a certain data format will constitute reliable evidence of a particular transaction, each party should face the presumption that such evidence will be valid in court if a dispute occurs. The American Bar Association is working on a model Trading Partner Agreement which should provide additional guidance.<sup>3</sup>

## AGREEMENTS WITH THIRD PARTY NETWORK PROVIDERS

EDI users often rely on third party networks to communicate with several trading partners. While these networks often provide form agreements that cover the relationship between the EDI user and the network, Mr. Wright argues that EDI users may want to negotiate changes to these forms.<sup>4</sup> Typically, these standard forms allocate virtually all the risks to the EDI user and shield the third party provider from any liability. For example, current forms often relieve the network provider from liability for data loss or errors in transmissions as well as for losses caused by acts of god. Many forms also excessively limit the time period in which the customer may file a legal action against the network provider. As the market becomes more competitive, EDI users

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2. B. WRIGHT, *EDI AND AMERICAN LAW* 21 (1989).

3. ABA Electronic Messaging Services Task Force, Subcommittee on Electronic Commercial Practices, Uniform Commercial Code, Model Form of Electronic Data Interchange Trading Partner Agreement (1989) [Hereinafter ABA Model Trading Partner Agreement].

4. B. WRIGHT, *supra* note 2, at 37-54.

should try to bargain for a more balanced distribution of risks and liabilities.

For the network user, Mr. Wright raises several concerns that EDI users should address before signing any service agreement. First, the EDI user should reserve all property rights to any data transmitted over the network. In absence of such an agreement, the third party provider could assert an artisan's lien on the data if network charges are not paid.<sup>5</sup> At the same time, the EDI user will want to negotiate the network's duties to backup information, to inform the EDI user if government authorities subpoena network data, and to make data available for internal and external audits. Just as important, Mr. Wright urges EDI users to carefully negotiate the allocation of risks for errors based on willful misconduct, negligence, or unavoidable disaster. The EDI user should at least insist on a negligence standard of care from the network provider, since the EDI user often needs both advice and troubleshooting from the network's professional staff.<sup>6</sup> At the same time, the EDI user should be prepared to assume adequate precautions to minimize damages caused by mistake. Mr. Wright suggests that the EDI user use acknowledgements, audit reports and security protections.

Presently, most network contracts include disclaimers against consequential damages.<sup>7</sup> Since these damages represent the greatest potential loss to an EDI user and its trading partners, the user should negotiate carefully so that both the user and network understand the risks they assume and that each side is adequately compensated for its share of the risks. Also, EDI users should be wary of clauses that limit the time that the user can bring suit against the network to one year. Mr. Wright warns that if the network provides professional services such as consulting or programming, one year may not be enough time to reveal problems with the service. The EDI user may want to negotiate for property rights in any custom programming work provided under the agreement so that the user can switch to another network provider without having to rewrite any special programs. Finally, the EDI user should insist that the network provider warrant that its service does not violate the copyright, trade secret, or patent rights of others, since an injured party might try to hold the EDI user responsible along with the network. As with the other sections of the book, Mr. Wright provides excellent sample clauses that could provide a starting point for negotiations.<sup>8</sup>

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5. *Id.* at 39.

6. *Id.* at 46.

7. *Id.* at 48.

8. *Id.* at 46-47.

## RECORDKEEPING

As companies automate previously manual transaction processes, they must also implement archive procedures that satisfy IRS regulations,<sup>9</sup> federal law,<sup>10</sup> and state corporate law.<sup>11</sup> Mr. Wright emphasizes the importance of these procedures by relating the story of Holt Hauling, a warehouse for imported goods that automated its bookkeeping but failed to design its system to provide proper documentation for Customs regulations.<sup>12</sup> Holt Hauling paid for its oversight by having its license suspended for one year. Since IRS regulations do not currently address the EDI environment, careful recordkeeping is essential to avoid later problems.

Mr. Wright effectively covers the scope of the recordkeeping problem and provides broad guidelines where possible. He also summarizes IRS regulations covering computerized accounting systems in general and notes that the user can ask the local IRS District Director to appoint a specialist to review their system. Finally, Mr. Wright recommends that the IRS design guidelines which address the diversity of EDI systems, the differing needs and capabilities of small and large companies, the costs to taxpayers, and the advantages and limits of automated IRS audits.

## ANTITRUST

Mr. Wright notes several areas in which EDI agreements could implicate users in antitrust problems.<sup>13</sup> Data shared among a small group of companies using the same EDI system could promote illegal price fixing or could be used to lock out smaller competitors who do not have access to the EDI network. Also, as EDI industry standards evolve, the designers must be wary of standards that inadvertently favor certain companies or networks.

## INNOVATIONS AND FUTURE EVOLUTION

Reading *EDI and American Law* may leave the EDI user with the sinking feeling that any efficiencies gained through EDI may be

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9. *Id.* at 63-65.

10. The federal Foreign Corrupt Practices Act requires all publicly held companies to record their transactions to ensure accountability for assets. See 15 U.S.C. § 78m (1989); B. WRIGHT, *supra* note 2, at 60-63.

11. B. WRIGHT, *supra* note 2, at 60. Many states require corporations to keep records for shareholder and government review. See Revised Model Business Corporation Act § 16.01 (1989).

12. Holt Hauling v. U.S. Customs Service, 650 F. Supp. 1013 (Ct. Int'l Trade 1986).

13. B. WRIGHT, *supra* note 2, at 69-75.

outweighed by the costs of legal counsel. In many areas, even competent counsel cannot eliminate all possibilities of legal pitfalls. However, help in the form of model agreements and uniform standards may eliminate much of the legal uncertainty surrounding implementation of EDI. Mr. Wright briefly covers developments such as ABA model agreements,<sup>14</sup> voluntary industry codes of conduct,<sup>15</sup> and new communications standards.<sup>16</sup>

## CONCLUSION

*EDI and American Law* provides an excellent overview of the legal pitfalls surrounding EDI. It also suggests ways in which EDI users can avoid these problems within the current legal and regulatory framework. Finally, Mr. Wright targets specific laws such as the the Fair Labor Standards Act,<sup>17</sup> the Controlled Substances Act,<sup>18</sup> Federal government procurement regulations,<sup>19</sup> and Article 2 of the UCC which require revisions to avoid frustrating EDI implementation. Armed with the analysis in *EDI and American Law*, EDI users should be in a strong position to advocate the necessary changes.

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14. See ABA Model Trading Partner Agreement, *supra* note 3.

15. Mr. Wright describes the Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission (UNCID) as established by the International Chamber of Commerce. B. WRIGHT, *supra* note 2, at 78-81.

16. Mr. Wright believes that EDI data will regularly use the X.400 standard, although he also covers alternative methods for open trading. *Id.* at 81-83.

17. The Fair Labor Standards Act forbids sale or resale of goods produced in violation of federal labor laws. However, 29 U.S.C. § 212(a) (1989) and 29 U.S.C. § 215(a)(1) (1989) permit a purchaser to rely on good faith *written* assurances from the original seller that the seller has complied with the provisions of the Fair Labor Standards Act. This provision is normally satisfied by written assurances appearing on printed order and invoice forms. Mr. Wright suggests several solutions to adapt EDI transactions to fit this provision, but notes amendment of the Fair Labor Standards Act may be necessary. B. WRIGHT, *supra* note 2, at 88-89.

18. 21 U.S.C. §§ 801-904 (1989). Mr. Wright notes that present DEA regulations require the purchaser to register all transactions on Form 222C which is issued exclusively by the DEA with tight controls and serial numbers on the form. 21 C.F.R. § 1305 (1989). As of May 1989, the DEA was looking toward modifying the regulations to allow the use of EDI in such transactions. B. WRIGHT, *supra* note 2, at 89.

19. 31 U.S.C. § 1501 (1989) requires that government contracts be evidenced by a *written* agreement. This provision effectively subjects government contracts to additional statute of frauds problems. B. WRIGHT, *supra* note 2, at 89-91.