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Electronic Signature Enforcement Exposure

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The rise of the internet has been disruptive to many traditions, and the humble paper contract is no exception. Dozens of online services now permit users to upload an image of their signature to digitally sign contracts. However, the warm feeling of complacency and technological superiority that can come with signing contracts with slick graphics and a smooth interface can be misleading, as one company recently learned in the case of *Williams v Crocker*.

This decision is a reminder to be vigilant and verify any signature on important documents, whether they are signed digitally or physically.

The facts

The Williams Group (the "**Lender**") is a supplier of building materials. In 2010 they provided a trade credit account to IDH Modular (the "**Debtor**"), a building company. Part of the trade credit application included a requirement that the three directors of the Debtor each provide a personal guarantee to the Lender, in effect, for the performance of the Debtor's obligations under the agreement.

The guarantees were signed by means of a third party electronic signature service cheerily named HelloFax and those signatures were "digitally witnessed" by the Debtor's administration manager.

In 2013, the Debtor owed around $900,000 under the agreement and the Lender took steps to recover the money from both the Debtor and the co-guarantors. The Debtor went into liquidation, automatically staying the proceedings against it under s440D of the *Corporations Act* and default judgment was awarded against two of the guarantors.

The third guarantor, Mr Crocker (the "**Guarantor**"), defended the claim and argued that his digital signature on the guarantee had been applied without his knowledge or authority.

The arguments

In both the first instance decision of Ward J in *Williams Group Australia Pty Ltd v Crocker* and the Court of Appeal decision in *Williams Group Australia Pty Ltd v Crocker*, the parties relied effectively on the same submissions, which are summarised as follows.

Poor security and ostensible authority

The Guarantor's position was rather simple and to the effect of:

> *I never signed the guarantee!*

The Guarantor argued that he had used the HelloFax system, which had been set up by a fellow director, but had never changed his default password. This lax approach to security permitted others within the Debtor company to potentially apply the Guarantor's signature to documents without the Guarantor's knowledge.

The Guarantor led evidence that, while he had uploaded two signatures to the HelloFax system, a third signature was

uploaded to the system by unidentified persons on the day the guarantee was signed. He said that this new signature was used to sign the guarantee.

The Lender, unsurprisingly, submitted that the Guarantor ought to be held responsible for his poor security setup, and asserted that in setting up such a vulnerable system, the Guarantor really should be found to have granted others either actual or ostensible authority to apply the Guarantor's signature to documents and bind the Guarantor to those documents.

The Supreme Court was unwilling to find for the Lender on this point and the Court of Appeal upheld this decision, citing the High Court judgment in *Pacific Carriers v BNP Paribas*. That decision makes clear that to make out ostensible authority there must be a clear representation from the principal (here the Guarantor) to another party (here the Lender) that is relied upon by the latter.

In the *Pacific Carriers v BNP Paribas* case, an employee of a bank lacked actual authority to issue letters of indemnity, but the bank had put in place "institutional trappings" which amounted to making representations that the employee had authority to issue the letters.

The Lender here was unable to point to any representation or holding out by the Guarantor which the Lender relied upon to show that someone else had authority to place the Guarantor's signature on the guarantee document.

The use of a third party digital signature software was not enough to amount to such "institutional trappings", particularly as the Lender did not have knowledge the HelloFax system was in use.

But all was not quite lost for the Lender, for even if the Guarantor had not signed or authorised the signing of the guarantee on his behalf, he could still be found to have ratified the guarantee.

Ratification

The Lender further argued that the Guarantor, having previously entered into a trade credit agreement with the Lender, and having received emails confirming what documents had been signed in the HelloFax system, and by being able to login to the HelloFax System and see what documents had been signed, had ratified the execution of the Guarantee as he had knowledge of what had been done.

The Guarantor argued that there was nothing in his behaviour which could amount to a positive ratification of the digital signature on the Guarantee. He claimed not to have received emails confirming what was signed in the HelloFax system and that there was no evidence he had seen a guarantee in the HelloFax system that had been signed with his digital signature.

The Supreme Court accepted this and the Court of Appeal affirmed that the correct application of the test of knowledge had occurred when the trial judge first considered the issue of ratification. The Lender was required (and had failed) to prove that the Guarantor had *"full knowledge of all the material circumstances under which the act was done"* or that the Guarantor had *"deliberately closed his eyes"* to the risks.

The Court of Appeal was, however, at least somewhat concerned with the issue of the Guarantor having received emails showing the documents that the Guarantor's signature had been affixed to, but was unwilling to treat this as the Guarantor having gone so far as to *"close his eyes"*.

The Court of Appeal specifically noted that the file name in HelloSign/HelloFax system, showing the document which had been signed, was only marked "credit application" and that this gave no indication to the Guarantor, when he subsequently logged in, that the document signed was in fact a personal guarantee.

Comment

Many in business, particularly those in a similar position to the Lender, might see this case as a perverse outcome as:

1. A guarantor chooses to use a digital signature system, but
2. Chooses to leave default passwords in place; which
3. Creates the opportunity for someone else to apply his signature to documents; then
4. Claims not to have received or read emails sent by that system when his signature is applied to a document; and
5. Seemingly as a result of these actions, is not held to the promises in the guarantee, to the detriment of the Lender.

Unfortunately the burden of proof a party must meet when enforcing a guarantee is often not considered when the guarantee is being established. That seems to have been the case here with the Lender simply accepting the signature at face value. Too often guarantees are considered a compliance issue and not treated with the same importance as the main agreement. As this case shows, such complacency can be expensive.

There are some relatively simple things that can be done to help you avoid ending up in a similar position to the Lender in this case:

1. Use a third party digital signature service that has greater visibility as to the timing of execution and better information as to how parties are authenticated and authorised to sign;
2. Make sure the requirement of providing the personal guarantee is communicated clearly to those providing the guarantee;
3. Require a guarantor to execute the guarantee as a separate and distinct document to a trade credit application; and
4. Identify your customers and guarantors by requesting 100 points of identification from a customer and guarantor (but note the implications under the *Privacy Act* in holding such information).

Integrating these steps into your contract administration process is well worth the initial costs if the time ever comes to call upon a personal guarantee.