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GLOBAL K: Crazy Ungenerous Arbitration Clauses

By Michael P. Malloy

Vonage America, part of Vonage Holdings with operations in the United States, Canada, and the United Kingdom, has encountered judicial hostility to the rather ungenerous arbitration provisions in its Terms of Service ("TOS") agreement. *See Merkin v. Vonage America Inc*. A class action suit filed in California state court in September 2013 (and later removed to federal district court for the Central District of California) charges that Vonage, a voice over Internet company, billed its customers for a monthly "Government Mandated" charge of $4.75 for a "County 911 Fee," despite the fact that no government agency mandated such a fee. The suit claims violations of the California Unfair Competition Law, Cal Bus. & Prof.Code §§ 17200, *et seq*., obtaining money under false pretenses contrary to Cal.Penal Code § 496, violations of the Consumer Legal Remedies Act, Cal. Civ.Code §§ 1750 *et seq*., fraud, unjust enrichment, and money had and received.

In December 2013, Vonage moved to compel arbitration under the mandatory arbitration provision in the TOS, and to dismiss or stay the case. Vonage contended that every customer who signs up for Vonage services is required to agree to the TOS as part of the subscription process, whether that process is performed online at Vonage's website, or by phone with Vonage sales personnel. The court considered it to be "of particular importance" that the TOS changed repeatedly since the two named plaintiffs signed up in 2004 and 2006. The April 2004 version provided

> . . . Vonage may change the terms and conditions of this Agreement from time to time. Notices [of changes in the TOS] will be considered given and effective on the date posted on to the "Service Announcements" section of Vonage's website. . . . Such changes will become binding on Customer, on the date posted to the Vonage website and no further notice by Vonage is required. This Agreement as posted supersedes all previously agreed to electronic and written terms of service, including without limitation any terms included with the packaging of the Device and also supersedes any written terms provided to Retail Customers in connection with retail distribution, including without limitation any written terms enclosed within the packaging of the Device.

The court noted that Vonage modified the TOS 36 times between April 2004 and October 2013 without providing notice to its customers other than posting changes to the TOS on its website. And how it grew! The court estimated that the 2004 version consisted of some 7,500 words organized into 6 sections, while the current 2013 version consists of 13,000 words organized in 18 sections. Still, Vonage insisted that each version contained a mandatory agreement to arbitrate and a mutual waiver of the right to bring or participate in a class action. For example, the current version of the TOS contains a provision that states:

> Vonage and you agree to arbitrate any and all disputes and

> claims between you and Vonage. Arbitration means that all disputes and claims will be resolved by a neutral arbitrator instead of by a judge or jury in a court. This agreement to arbitrate is intended to be given the broadest possible meaning under the law.

The current version of the TOS also contained language restricting the consumer from bringing claims "as a plaintiff or class member in any purported class or representative proceeding." (The provision purported to restrict *both* the consumer *and* Vonage, but the operative language of the restriction clearly applied lopsidedly to the consumer.) Naturally, Vonage took the position that the TOS arbitration provisions covered the individual plaintiffs' claims and barred them from proceeding in a representative capacity.

In response, the plaintiffs argued that they never agreed to the TOS, but the court could not countenance this. Vonage had shown that service sign-up could not be completed, nor could a customer use the service, without accepting the TOS. The best the Plaintiffs could do was to say that they did not "recall ever clicking on an 'I agree to the Terms of Service' button, or something similar to that." Clearly, this was insufficient in the face of clear design information. Further, if the argument is simply about never *reading* the clickwrap language, the court made it clear that "failure to read a contract is no defense to [a] claim that [a] contract was formed. Moreover, courts routinely enforce similar "clickwrap" contracts where the terms are made available to the party assenting to the contract," citing *Guadagno v. E*Trade Bank* and *Inter–Mark USA, Inc. v. Intuit,* Inc.

The plaintiffs' ultimate position, however, was that in any event the TOS was unconscionable, and therefore unenforceable under California law, relying on the Ninth Circuit's 2013 decision in *Kilgore v. KeyBank, Nat. Ass'n*, which in turn relied upon the Supreme Court's 1996 decision in *Doctor's Assocs., Inc. v. Casarotto*. The import of these cases was that generally applicable contract defenses – including fraud, duress, or unconscionability – were available to invalidate an arbitration agreement without contravening the mandate of the Federal Arbitration Act to counteract "widespread judicial hostility to arbitration agreements" and to reflect "a liberal federal policy favoring arbitration," as the Supreme Court noted in its 2011 decision in AT&T Mobility LLC v. Concepcion.

On the issue of unconscionability, the parties launched into an extended debate as to which version of the TOS was relevant to the argument – the version as of the date of sign-up, or the current version, which was arguably more "consumer friendly." The court swept all of this aside, declaring that it was "not necessary to resolve which version of the TOS controls for purposes of the unconscionability analysis. Even assuming that Vonage is correct and the current (allegedly more consumer-friendly) TOS is the salient version of the TOS, the Court finds that . . . the arbitration agreement contained in the current TOS is unconscionable." Hence, the court assumed for purposes of its analysis and explanation that the current TOS governed.

Unlike the situation in *Rent–A–Center, West, Inc. v. Jackson*, the TOS did not include any provision "delegating" the issue of unconscionability to the arbitrator, despite the language giving the arbitration agreement "the broadest possible meaning under the law." The court therefore proceeded with its own analysis. It began with the basic proposition that, *per Kilgore*, to be considered invalid under California law a contract must be both procedurally and substantively unconscionable. As to procedural unconscionability, the court found that the TOS evinced "a substantial degree of both oppression and surprise." There was no dispute that the TOS was a contract of adhesion, which

was the threshold inquiry. The consumer was confronted with the TOS during sign-up, and there was no real choice or possibility of negotiation. The consumer "must either accept the TOS in the entirety, or else reject it and forego Vonage services." While there is support in older California case law for the proposition that adhesion and oppression are not identical (*see, e.g., Dean Witter Reynolds, Inc. v. Superior Court*), recent Ninth Circuit case law on the subject argues that contracts of adhesion are *per se* oppressive. *See* Newton v. Am. Debt Servs., Inc. Beyond this, the court found other clear features of oppression – the company's unilateral ability to modify the TOS, "the largely unfettered power to control the terms of its relationship with its subscribers," the lack of any "balance of bargaining power" – and concluded that the TOS involved a high degree of oppression.

The second factor in procedural unconscionability analysis is the question of surprise. The court was quick to emphasize that "surprise is not a necessary prerequisite for procedural unconscionability where, as here, there are indicia of oppressiveness," citing the 2004 California case *Nyulassy v. Lockheed Martin Corp*. However, the court did find that there were significant features of surprise – arbitration terms buried within a lengthy contract, no separately provided arbitration agreement, no requirement that consumers separately agree to the agreement – although there was a TOS table of contents and a bolded, cautionary instruction introducing the provision. On balance, however, the court considered the finding of surprise to be "augmented by Vonage's repeated modification of the TOS" in 36 versions updated without any prior notice to the consumers. This led to a strong showing of surprise, and the court concluded that "[b]ecause the arbitration provision involves high levels of both oppression and surprise, the Court finds a high degree of procedural unconscionability."

As to substantive unconscionability, the court's view of the pertinent case law was that an arbitration provision was substantively unconscionable if it was "overly harsh" or generated "one-sided results." The court found that the TOS lacked mutuality – while purporting to require arbitration of "any and all disputes between [the consumer] and Vonage," the TOS actually carved out exceptions for any type of claim likely to be brought by Vonage, for example, small claims, debt collection, disputes over intellectual property rights, claims concerning fraudulent or unauthorized use, theft, or piracy of services. Accordingly, the court concluded that the arbitration provision lacked even a "modicum of bilaterality," and was therefore substantively unconscionable. Given the high degree of procedural unconscionability as well, the court found that the arbitration provision was unconscionable.

For several reasons, severance of the offending features was not appropriate. The high degree of procedural unconscionability tainted "not just the specific carve-out provision, but also the TOS and arbitration provision more generally." Furthermore, previous versions of the TOS as well contained a variety of provisions that were likely to operate in an unconscionable way – a forum selection provision likely to be extremely inconvenient for consumers, restrictions on the ability of arbitrators to award relief to consumers, a shortened limitations period. Finally, the repeated modifications of the TOS made it difficult for the court to determine "what the TOS would look like in the absence of the offending provision." In light of the repeated modification of the contract, it was unclear what contractual relationship could or should be conserved.

Two final points of general application are worth noting. First, the implications of the case suggest a broader impact on the telecommunications sector generally. Vonage had tried to argue that the contract was not oppressive because the plaintiffs had the option to procure telecommunications services from other providers, and thus had meaningful alternatives to contracting with

Vonage. The court found this argument unpersuasive, and observed, somewhat ominously,

> Vonage presents no evidence that plaintiffs in fact had meaningful alternatives to agreeing to arbitrate their claims. At most, Vonage presents evidence that the telecommunications market is competitive. . . . But Vonage does not demonstrate that plaintiffs could have procured equivalent telecommunications services from these competitors without being required to sign a similarly restrictive arbitration agreement. Indeed, as Vonage itself points out, "a 'sizable percentage' of [telecommunications and financial services companies] use arbitration clauses in [their] consumer contracts." . . .

One might well wonder who among Vonage's competitors will be next up for a class action challenge. Will they be "vonaged" as well?

Second, the *Merkin* decision may raise questions about the effectiveness of ostensible "opt-out" provisions that on-line providers tout in anticipation of criticism of their subscription practices. Vonage tried to argue that the TOS was not oppressive because a provision gave subscribers the possibility of opting out of any substantive change to the arbitration provision, through the transmittal of an "opt-out notice" within thirty days of the time the TOS was modified. The Court found this claim to be unpersuasive in the absence of *prior notice*. As the court explained,

> Vonage did not provide separate notice to its subscribers when modifying the TOS; modifications were instead effective at the time they were posted to the Vonage website. As such, opting out would require a subscriber to constantly monitor the Vonage website for modifications to the TOS in order to ensure that the brief thirty-day window did not elapse. Indeed, Vonage itself appears to admit that no Vonage subscriber has ever availed himself of the thirty-day opt-out. . . . In such circumstances, the right to opt-out does not act as a meaningful check on Vonage's power to unilaterally impose modifications on its subscribers and provide subscribers with a meaningful opportunity to avoid the impact of those modifications.

Should the *Merkin* court's view of the linkage between prior notice, opt-out, and validity become widely endorsed, online merchants might well find themselves in the shocking position of being required to provide *meaningful* notice to their consumers if they wish to continue to oppress them. Would this be crazy . . . or crazy generous to consumers?

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