

1-1-2009

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Recommended Citation

Ben Casady, *Electronic Pitfalls: The Online Modification of Ongoing Consumer Service Agreements*, 5 SHIDLER J. L. COM. & TECH. 12 (2009).

Available at: <https://digitalcommons.law.uw.edu/wjlta/vol5/iss3/2>

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ELECTRONIC PITFALLS: THE ONLINE MODIFICATION OF ONGOING CONSUMER SERVICE AGREEMENTS

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Abstract

This Article examines the procedure for online modification of an ongoing consumer contract. It reviews the relevant case law, including *Douglas v. U.S. District Court*, a recent Ninth Circuit decision that calls into question the validity of changing contractual terms by merely posting the changes on the service provider's Web site. The Article also examines the discrete components found in an effective online contract modification and provides practical pointers for contract drafters.

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INTRODUCTION

Perhaps now more than ever, Americans find themselves in long-term contractual relationships with their service providers.² The average American may have an ongoing consumer service agreement (a "CSA") with a cell phone provider, long-distance telephone carrier, cable or satellite television provider, and one or more credit card issuers. Many of these relationships are managed in whole or part through Web sites that permit service subscribers to view their account activity, manage the level of service received, and pay outstanding balances.

Service providers tend to change the terms of their CSAs from time to time, and the prospect of announcing such changes through their Web sites is an attractive, cost-effective option. *Douglas v. U.S. District Court*, however, a recent opinion from the Ninth Circuit, should serve as a reminder to service providers that certain protocols must be followed for online modifications to consumer contracts to be upheld.³ This Article will first briefly discuss the law applicable to the modification of service contracts. Next, it will examine *Douglas* within the broader context of the basic underpinnings of contract modification. Finally, the article will provide practice pointers to assist drafters in preparing valid online contract modifications.

AN OPENING QUESTION: DOES FEDERAL LAW OR STATE LAW APPLY

Federal law regulates many of the industries that routinely rely on consumer service agreements. Yet, at least when it comes to the modification of CSAs, state contract law will typically determine whether a modification is valid. This is true in the case of credit card agreements,⁴ wireless communications agreements,⁵ and cable television services contracts.⁶

For example, with respect to long distance telephone CSAs, the Seventh Circuit has held that the Federal Communications Act ("FCA") preempts state law in regards to the terms of long-distance CSAs.⁷ By contrast, the Ninth Circuit has held that the 2001 detariffing⁸ of long-

distance carriers requires that state contract law be applied to long-distance CSAs.⁹ This view is supported by pre-detariffing decisions in the Second and Sixth Circuits.¹⁰ Indeed, the Federal Communications Commission ("FCC") itself has stated that "consumers may have remedies under state consumer protection and contract laws as to issues regarding the legal relationship between the carrier and customer" ¹¹ Additionally, a number of cases also consider the Federal Arbitration Act,¹² which is commonly implicated in such cases, where modification of a CSA involves the imposition or enforcement of arbitration provisions.¹³

Given the trend in applying state contract law to long-distance service contracts, lawyers in this field, like those dealing with the wireless, television, or credit industries, should heed relevant state contract law when drafting contract modifications. However, while state contract law may control in many instances, other laws may be applicable depending on the particular agreement clause involved.

OVERVIEW OF PERTINENT CONTRACT LAW FOR AMENDING THE TERMS OF CONSUMER SERVICE AGREEMENTS

The *Douglas* Court examined the validity of using a Web site to inform consumers of a change in the terms of their CSAs. The critical issue in *Douglas* was whether the binding arbitration provision of the CSA at issue was enforceable against the consumer in spite of the fact that the arbitration provision was the result of an online modification.¹⁴ The Ninth Circuit, applying California state contract law, implicitly held that the procedures employed by Talk America did not provide its subscribers with proper notice of the new terms and the online modification was, therefore, unenforceable.¹⁵

To understand the Ninth Circuit's reasoning in *Douglas*, it is necessary to first discuss the basic underpinnings of contract modification law. Although contract law varies from state to state, three factors have near-universal relevance for contract modification: first, the contract must be amenable to change; second, consent to the modification is required; and third, proper notice of the change in terms must be given for the consumer's consent to be effective. As noted, the central issue in the *Douglas* case implicates the third factor: does simply posting an updated contract on a Web site constitute proper notice? Each of these three factors will be examined below.

The Contract Must Be Amenable to Change

CSAs typically contain a provision enabling the service provider to change the terms of the contract from time to time.¹⁶ But some courts have found that, even with such 'change of terms' provisions, unilateral contract modifications should be limited to subject matters contemplated in the original contract.¹⁷ One California court, for instance, found that the terms in a bankcard CSA, which only referenced fees, percentage rates, methods of calculating account balances, and the like, did not alert customers the possibility that a 'change of terms' provision would empower the bank to "terminate its customers' right to have disputes resolved in the civil justice system" by adding an arbitration clause.¹⁸ In response to such types of cases, Delaware has enacted statutes that permit the addition of terms that were not necessarily contemplated in the original contract.¹⁹ In all other states, however, drafters of new CSAs should consider referencing the possibility that the service provider's dispute resolution policies might be modified, even if the CSA as written will not contain a dispute resolution policy.

Consent to Modification Is Required

By changing the terms of a CSA, the service provider is essentially offering a new contract.²⁰ To minimize the likelihood of the terms being found non-binding, the service provider should give the consumer a chance to accept or reject the contract.²¹ Generally, the service provider can structure the offer so that the consumer accepts the change in terms by continuing to use the service. Conversely, the offer can be structured so that the consumer's rejection of the modification comes by quitting the service without penalty.²²

An example of a court approving of a consumer's acceptance-through-continued-use and non-

cancellation of the service can be found in *Boomer v. AT&T Corp.*²³ In that case, the appellant argued that he had no opportunity to reject defendant service provider's CSA. The court held that language in the proffered CSA gave the plaintiff ample opportunity to reject the offer; the contract stated that "IF YOU DO NOT AGREE TO THESE . . . TERMS AND CONDITIONS, DO NOT USE THE SERVICES, AND CANCEL THE SERVICES IMMEDIATELY."²⁴

Proper Notice of the Modified Terms Is Required for Consent to Be Effective

The concept of proper notice is implicit in the notion that the consumer must be given the option to reject the newly revised CSA. After all, "[a]n offer may not be accepted until it is made and brought to the attention of the one accepting."²⁵

Although courts have varying definitions for what constitutes proper notice, the concept invariably revolves around whether a consumer would understand that a modification of the original contract had occurred.²⁶ This inquiry is intensely fact specific and often turns on small details of timing, language, and physical particulars.

For example, *Badie v. Bank of America* turned on the language of the notification. The California Court of Appeals held that the notice was deficient because of language in the modification meant to obfuscate and downplay the binding nature of the arbitration.²⁷ A divided Maryland Court of Appeals similarly held that simply mailing an updated CSA without noting that the CSA had been changed was not sufficient to achieve proper notice. In *DIRECTV, Inc. v. Mattingly*, the appellant cable service amended its CSA and mailed it to the appellee without calling attention to the changes.²⁸ The court, noting the burden of "meticulously comb[ing] through both documents line by line," found that the modifications were not binding absent notice intended to call the user's attention to the changes in the revised CSA.²⁹

The components of the notification are also important. In *Briceno v. Sprint Spectrum, L.P.*, a Florida court held that a notice in a monthly statement was sufficient to apprise a user of her rights.³⁰ The notice was titled "Important Notice Regarding Your PCS Service from Sprint," printed in bold lettering and placed immediately below the amount due.³¹ By contrast, in *Manasher v. NECC Telecom*, a Michigan district court found that a notice on an invoice failed to adequately incorporate by reference an online CSA.³² The notice failed, in part, because it was the fifth item on the second page of the invoice and the print font was ordinary.³³ Moreover, the language of the notice was faulty, as it merely informed consumers that NECC's "Disclosures and Liabilities Agreement" was available via the Web or an 800 number; the changes also failed to state that the modification itself formed part of an agreement between the parties, or that it was intended to be incorporated into the parties' agreement.³⁴

Although the *Manasher* Court did not find the service provider's online CSA to be binding, other courts have accepted notices that referred to web-delivered CSA modifications, provided that reasonable notification and access are also provided.³⁵ In *Briceno*, for example, the court found that Sprint provided adequate notice when it prominently announced a change in terms in the monthly bill, along with both a Web address and telephone number where the consumer could access the revised CSA.³⁶ Additionally, in *Crawford v. Talk America, Inc.*, the plaintiff claimed that her long-distance provider failed to provide her with a copy of its CSA.³⁷ Although the service provider did not supply the consumer with a copy of its CSA, it did send her a written notice providing a Web address and a toll-free number where the plaintiff could request a copy.³⁸ The court found that Crawford knew where to obtain the terms, and going online or making a phone call was not a real obstacle to access.³⁹

As with the other cases, the service provider's failure to affirmatively notify the consumer of the change is the central issue in *Douglas* as well.

THE DOUGLAS DECISION

Joe Douglas contracted for long-distance service with America Online ("AOL"), which subsequently sold its long distance telephone service, including the contract for Mr. Douglas' service, to Talk America, Incorporated ("Talk America").⁴⁰ Talk America modified the CSA to include an arbitration clause, a waiver of the right to bring a class-action, and other

amendments.⁴¹ Also, it posted the revised terms on its Web site, but otherwise failed to notify Douglas of the changes.⁴² Douglas continued to use Talk America's service for four years after the CSA revision,⁴³ although there was some dispute as to whether Douglas utilized AOL or Talk America's Web site to set up an automatic monthly payment of his bill.⁴⁴

The relationship between the parties soured, and Douglas filed a class-action suit against Talk America alleging violation of the Federal Communication Act and various California consumer protection statutes.⁴⁵ The district court granted Talk America's motion to compel arbitration per the terms of its revised CSA.⁴⁶ Douglas then petitioned the Ninth Circuit Court of Appeals, which issued a writ of mandamus vacating the district court's order compelling arbitration.⁴⁷

The district court based its reasoning, in part, on the fact that Douglas may have paid his bills on the same Web site that Talk America used to post its revised CSA.⁴⁸ The Ninth Circuit reversed.⁴⁹ It found that, even if Douglas had used the site, simply posting the amended CSA on the site failed to rise to the level of adequate notice.⁵⁰ Douglas had no reason to look at the contract posted there, as "parties to a contract have no obligation to check the terms on a periodic basis to learn whether they have been changed by the other side."⁵¹ Without having reason to know of the change, the court suggests that, under Talk America's system, Douglas would be in the absurd position of having to "compare every word" of the posted CSA against his own version in order to keep informed of his obligations on a daily basis.⁵² Indeed, the lower court's decision reflected a "fundamental misapplication[] of contract law" by upholding the modified terms when Talk America had failed to properly notify Douglas.⁵³

Moreover, the panel noted two other mistakes that militated issuing the writ of mandamus. First, the trial court's decision ignored California case law holding that service providers cannot impose arbitration policies against existing customers.⁵⁴ Second, the trial court failed to consider whether the class action waiver included in the amended CSA would be unconscionable under state law.⁵⁵ While these factors are outside the scope of this article, they serve as a reminder to contract drafters to be aware of the various state-based consumer protection laws that could affect the validity of a CSA modification.

PROPER NOTICE AFTER DOUGLAS

Although using a Web site to amend a consumer service agreement may appear to be a cost effective alternative to physical mailings, service providers should use this practice with caution. Cases like *Briceno v. Sprint Spectrum, L.P.* and *Crawford v. Talk America, Inc.* suggest that providing easy access to a CSA through a Web site or telephone number is a viable way of disseminating this information. But *Douglas*, like *DIRECTV v. Mattingly* before it, teaches that mere access to the amended CSA is not enough. In both of those cases, the service provider made the updated CSA easily accessible, yet failed to put consumers on notice that a change had occurred.

Clearly, a post-*Douglas* service provider would be foolish to simply modify the CSA posted on its Web site and do nothing more. It is well established that the service provider must give consumers notice reasonably designed to apprise them of the changes in order for a change of terms to be effective. *Douglas*, however, offers little insight into just how much more notification is necessary. Would an email to consumers stating that the CSA terms have been modified and containing links to the amended CSA posted on a service provider's Web site be sufficient? Does the email or the Web site have to identify the changes?

Cases like *Briceno* and *Crawford* that allowed contracts to be accessed via the Internet or by telephone, suggest that the courts may be getting closer to allowing online notification of contract amendments to CSA's. However, at least for the foreseeable future, the element of proper notice will require that the service provider reach out to the consumer in some fashion in order to put them on notice regarding the contract modification. Absent special circumstances, simply posting an updated contract on a Web site will likely never be a valid way for a service provider to notify its consumers of a change in the terms of an ongoing consumer service agreement.

PRACTICE POINTERS

- When initially drafting a consumer service agreement (“CSA”), attorneys should reference any terms (like dispute resolution) that the service provider may wish to change at a later date. To make the change effective, the drafter should include a right of the provider to modify the terms of the CSA.
- At a minimum, service providers must alert their customers to a change in the CSA. The best practice probably entails including the changes themselves in the notice. If the changes themselves are not included in the notice, the notice must, minimally, inform consumers as to where to find the changes. Furthermore, the communications must provide consumers with a relatively hassle-free means of accessing the revised CSA (e.g., by providing access through a Web address or toll-free telephone number).
- When determining if a service provider has given proper notice, courts will consider the overall effect of the notice, including the use of clear language, the font type and size, and the placement of the text within the larger body of the communication itself.
- The notice of contract modification should be accompanied by a procedure for opting out of the agreement. This may be achieved by requiring consumers to quit the service (preferably without a significant penalty) if they do not agree to the modified CSA.
- Proper notice is only one element of contract modification. Attorneys should also be cognizant of relevant state consumer protection statutes and case law pertaining to contract unconscionability.

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Footnotes

1. Ben Casady, University of Washington School of Law, J.D., 2009. Thank you to Professor Jane Winn of the University of Washington School of Law and Jeffrey Bashaw, student editor, for their help and feedback. I am also grateful to Elaine D. Ziff, of Skadden, Arps, Slate, Meagher & Flom, LLP, for her invaluable assistance in improving this article. Finally, I would be remiss if I did not thank Helen, my wonderful wife and companion, for her love and support.
2. A 2007 study found that one in seven Americans carry 10 or more credit cards. This number was up from one in nine in 2004. Marilyn Lewis, *1 in 7 Americans Carry 10 or More Credit Cards*, MSN MONEY, Feb. 14, 2007, <http://articles.moneycentral.msn.com/Banking/CreditCardSmarts/1In7AmericansCarries10CreditCards.aspx?GT1=9113>.
3. *Douglas v. U.S. Dist. Court*, 495 F.3d 1062 (9th Cir. 2007) (per curiam).
4. See *Perry v. FleetBoston Fin. Corp.*, No. 04-507, 2004 U.S. Dist. LEXIS 12616, at *5 (E.D. Pa. July 6, 2004) (explaining that courts look to state contract law regarding arbitration, even if the suit is based on federal consumer credit laws).
5. See *Fedor v. Cingular Wireless Corp.*, 355 F.3d 1069, 1071-73 (7th Cir. 2004) (explaining that, in the wireless industry, state law is preempted by federal regulation only when the claim involves the court in ratemaking or market entry).
6. See *DIRECTV v. Mattingly*, 829 A.2d 626, 631 (Md. 2003) (explaining that the issue of whether the terms of a satellite television contract are binding is predicated on state contract law rather than federal law).
7. See *Dreamscape Design, Inc. v. Affinity Network, Inc.*, 414 F.3d 665 (7th Cir. 2005) (holding that state law could not invalidate the terms and conditions of long-distance contracts). However, the *Dreamscape* Court also recognized that “Congress envisioned *some* role for state law after detariffing, so federal law no longer completely preempts the entire field.” *Id.* at 673 (citing *Boomer v. AT&T Corp.*, 309 F.3d 404, 424 (7th Cir. 2002)).
8. See *generally* *Ting v. AT&T Corp.*, 319 F.3d 1126, 1130-33 (9th Cir. 2003) (discussing detariffing).

9. *Id.* at 1146 (holding that “state contract and consumer protection laws form part of the framework for determining the rights, obligations and remedies of the parties to a CSA.”).
10. *Manasher v. NECC Telecom*, No. 06-10749, 2007 U.S. Dist. LEXIS 68795, at *32 (E.D. Mich. Sept. 18, 2007) (holding that contract formation issues must be decided by state, rather than federal law); *see also* *Marcus v. AT&T Corp.*, 138 F.3d 46, 54 (2d Cir. 1998) (holding that the FCA does not preempt state law actions prohibiting deceptive business practices, false advertising, or common-law fraud in a pre-detariffing case); *see also* *In re Long Distance Telecommc’ns Litig.*, 831 F.2d 627, 633 (6th Cir. 1987) (finding that charges of fraud do not require agency expertise).
11. *In re Policy and Rules Concerning the Interstate, Interexchange Marketplace Implementation of Section 254(g) of the Communications Act of 1934*, 12 FCC Rcd. 15014, 15057 (1997).
12. Federal Arbitration Act, 9 U.S.C. § 2 (2006); *see also* S. 931, 111th Cong. (2009) (proposing amendments to Federal Arbitration Act).
13. *See Ozormoor v. T-Mobile USA, Inc.*, No. 08-11717, 2008 U.S. Dist. LEXIS 58725, at *6-8 (E.D. Mich. June 19, 2008) (discussing the relevance of federal arbitration policies).
14. *Douglas v. U.S. Dist. Court*, 495 F.3d 1062, 1066-67 (9th Cir. 2007) (per curiam).
15. *Id.* at 1067.
16. An example of the ubiquity of the ‘change of terms provision’ can be found in *Badie v. Bank of America*, 67 Cal. App. 4th 779, 787 (1998), where the bank’s expert witness testified that including such provisions had been “the standard industry practice since bank credit cards first became available in the 1960’s.”
17. *See, e.g., Perry v. FleetBoston Fin. Corp.*, No. 04-507, 2004 U.S. Dist. LEXIS 12616, at *7-8, *16 (E.D. Pa. July 6, 2004) (noting that if the plaintiffs had continued to use their cards after receiving notice of the changes, “they would have manifested their assent to the new term” and thus, presumably, the issue would have been moot). The *Perry* Court also gives an overview of cases resolving this issue. *Id.* at *7-8.
18. *See Badie*, 67 Cal. App. 4th at 799-801.
19. Delaware is one of the leading states for corporate law. *See Edelist v. MBNA Am. Bank*, 790 A.2d 1249, 1257-58 (Del. Super. Ct. 2001) (analyzing Title 5 sec. 952 of the Delaware Code, which allows banks to make extensive unilateral changes to CSAs).
20. *Douglas v. U.S. Dist. Court*, 495 F.3d 1062, 1066 (9th Cir. 2007) (per curiam) (“[A] revised contract is merely an offer and does not bind the parties until it is accepted.”) (citing *Matanuska Valley Farmers Cooperating Ass’n v. Monaghan*, 188 F.2d 906, 909 (9th Cir. 1951)).
21. *See* RAYMOND T. NIMMER, *LAW OF COMPUTER TECHNOLOGY* § 14:61 (3d ed. 1997).
22. While it is undoubtedly the safer legal choice, whether the service provider *must* allow a consumer to reject a change without penalty may be an open question. *See Briceno v. Sprint Spectrum, L.P.*, 911 So. 2d 176, 180-81 (Fla. Dist. Ct. App. 2005) (noting in dicta that the “enforcement of an early termination fee, coupled with more onerous terms or amendments, could render an amendment unconscionable and, thus, unenforceable.”).
23. *Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002).
24. *Id.* at 415; *see also* *Ozormoor v. T-Mobile USA, Inc.*, No. 08-11717, 2008 U.S. Dist. LEXIS 58725, at *8 (E.D. Mich. June 19, 2008) (explaining that Ozormoor’s receipt of a copy of the CSA and continued use of his wireless phone constituted acceptance of the terms).
25. *Douglas*, 495 F.3d at 1066 (quoting *Trimble v. N.Y. Life Ins. Co.*, 234 A.D. 427, 431 (N.Y. App. Div. 1932)).

26. *See, e.g.*, *DIRECTV v. Mattingly*, 829 A.2d 626, 636 (Md. 2003) (observing that “proper notice” requires that the customer receive “enough information to make an informed decision”); *see also* *Briceno v. Sprint Spectrum, L.P.*, 911 So. 2d 176, 180 (Fla. Dist. Ct. App. 2005) (noting that consumer must be given “a fair and clear warning of changes”); *see also* *Badie v. Bank of Am.*, 67 Cal. App. 4th 779, 805 (1998) (explaining that notice must be designed to achieve “knowing consent”).
27. *Badie*, 67 Cal. App. 4th at 805-06 (addressing a contract in which Bank of America sought to add an alternate dispute resolution clause).
28. *DIRECTV*, 829 A.2d at 627-30.
29. *Id.* at 634. The dissent, however, argues that a reasonable consumer would be put on notice of potential changes by a different effective date on the front page of the newer CSA. *Id.* at 640-41.
30. *Briceno v. Sprint Spectrum, L.P.*, 911 So.2d 176 (Fla. Dist. Ct. App. 2005).
31. *Id.* at 180.
32. *Manasher v. NECC Telecom*, No. 06-10749, 2007 U.S. Dist. LEXIS 68795 (E.D. Mich. Sept. 18, 2007).
33. *Id.* at *10-14.
34. *Compare Manasher*, 2007 U.S. Dist. LEXIS 68795 with *Ozormoor v. T-Mobile USA, Inc.*, No. 08-11717, 2008 U.S. Dist. LEXIS 58725, at *2 (E.D. Mich. June 19, 2008) (addressing the incorporation of the rules of arbitration association into the CSA by giving notice with the following language: “INCORPORATED HEREIN BY THIS REFERENCE” and additional information available through a toll-free phone number or Web site).
35. *See, e.g.*, *Briceno v. Sprint Spectrum, L.P.*, 911 So.2d 176 (Fla. Dist. Ct. App. 2005); *see also* *Crawford v. Talk Am., Inc.*, No. 05-CV-0180-DRH, 2005 U.S. Dist. LEXIS 23181 (S.D. Ill. Oct. 6, 2005).
36. *Briceno*, 911 So.2d at 180.
37. *Crawford*, 2005 U.S. Dist. LEXIS 23181.
38. *Id.* at *9.
39. *Id.* at *12-13. Although *Crawford* deals with a new CSA rather than a modification, its analysis is still relevant to the topic at hand.
40. *Douglas v. U.S. Dist. Court*, 495 F.3d 1062, 1065 (9th Cir. 2007) (per curiam).
41. *Id.*
42. *Id.* at 1065.
43. *Id.*
44. *Douglas v. U.S. Dist. Court*, 495 F.3d 1062, 1066 (9th Cir. 2007) (per curiam).
45. *Id.* at 1065.
46. *Id.* at 1065.
47. *Id.* at 1069.
48. *Douglas v. Talk Am., Inc.*, No. CV-06-3809-GAF, 2006 U.S. Dist. LEXIS 97210, at *6 (C.D. Cal. Oct. 20, 2006).
49. *Douglas v. U.S. Dist. Court*, 495 F.3d 1062, 1065-66 (9th Cir. 2007) (per curiam).
50. *Id.* at 1067.
51. *Id.* at 1066.
52. *Id.* at 1066 n.1.

53. *Id.* at 1067.

54. Douglas v. U.S. Dist. Court, 495 F.3d 1062, 1067 (9th Cir. 2007) (*per curiam*).

55. *Id.* at 1067-68.