

MARC BRAGG, Plaintiff, v. LINDEN RESEARCH, INC. and PHILIP ROSEDALE,  
Defendants.

CIVIL ACTION NO. 06-4925

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

487 F. Supp. 2d 593; 2007 U.S. Dist. LEXIS 39516

May 30, 2007, Decided

**Writer- Shiva Fatoorechi**

**Procedural Posture:**

Bragg, Plaintiff, was the owner of virtual property on Second Life (an online virtual world), and brought suit against the operators of Second Life, Linden labs after the operator's removed virtual property purchased by the plaintiff and put a freeze on the user's account. Second life's CEO filed a motion to dismiss, claiming lack of personal jurisdiction. The operators of Second Life (Linden Lab) filed a motion to compel arbitration, as was set out in the Terms of Service agreement entered into by Bragg prior to joining Second Life.

**Background:**

After purchasing virtual property on second life, Bragg contends that the owners of the site wrongfully confiscated his acquired property and denied him further access to the virtual world. The CEO of second life claimed that the court did not have personal jurisdiction over him, since he is based out of San Francisco and the case was brought forth in the Eastern district of Pennsylvania. The court however did not find this argument persuasive. The CEO had attended representations in several national complains to induce people to become a part of Second Life.

These appearances were held to be sufficient contacts to render personal jurisdiction over the CEO.

The court also did not find the operator's motion to compel arbitration to be compelling. Although there was a clause in the terms of service agreement stating that all users must first seek arbitration for legal issues encountered in second life, the court found this term to be both procedurally and substantively unconscionable. The term was not conspicuous, buried among many other provisions. And was presented to the user on a take it or leave it basis. Since second life is the only site that allows users intellectual property in the virtual realm, the user did not have other options to seek (i.e. other virtual worlds), and was thus given no choice but to comply with the terms of the agreement. The arbitration clause was also unnecessarily one sided, taking into account the high cost of arbitration, the burdens associated with the forum selection clause, and the extreme confidentiality provision.

**Courts holding:**

The court thus dismissed both the motion to dismiss for lack of personal jurisdiction as well as the motion to compel arbitration.

Recent cases

AT&T terms found unconscionable

**Date:** 08-31-2008

**Case Style:** Michael McKee v. AT&T Corporation

**Case Number:** 81006-1

**Judge:** Tom Chambers

**Court:** Supreme Court of Washington on appeal from the Superior Court of Chelan County

**Plaintiff's Attorney:** [Scott Kane](#), East Wenatchee, Washington; Leslie A Bailey, Public Justice, PC, Oakland, California; F. Paul Bland, Public Justice, PC, Washington, DC

Katherine M Tassi, Washington State Attorney General's Office, Seattle, Washington - Amicus Curiae on behalf of Attorney General of Washington

Kelby Dahmer Fletcher, Peterson Young Putra, Seattle, Washington; Sarah C. Schreck, Portland, Oregon; Bryan Patrick Harnetiaux, Spokane, Washington - Amicus Curiae on behalf of Washington State Trial Lawyers Association

**Defendant's Attorney:** Daniel Maring Waggoner and Cassandra Lynn Kinkead, Davis Wright Tremaine LLP, Seattle, Washington

**Description:** Michael McKee filed this class action suit, alleging AT&T wrongly charged him (and others) city utility surcharges and usurious late fees. When the Chelan County Superior Court found the dispute resolution provision of AT&T's Consumer Services Agreement unconscionable and denied its motion to compel arbitration, AT&T appealed. The Court of Appeals, Division Three, certified the case to this court. We affirm the trial court and remand for further proceedings. Facts McKee lives near Wenatchee, Washington, and signed up for AT&T long distance phone service in November 2002. His monthly bills included a Wenatchee city utility tax surcharge, even though he lives outside the Wenatchee city limits. When he called AT&T to resolve this issue, at first, the various operators merely tried to sell him a new long distance package. Finally, he was told that taxes were assessed by zip code. Unfortunately, McKee's zip code includes people who live both inside and outside the Wenatchee city limits. McKee contends that AT&T collects the tax from all of its customers who live within the zip code, whether the customers owe the tax or not. A late fee of 1.5 percent applies if the customer does not pay all charges on time. The charges McKee challenges amount to no more than \$2 in any given month, less than \$20 total in a year. But McKee notes that after many years and many customers, small amounts add up to very large sums.

After his individual attempts to resolve his billing issues with AT&T failed, McKee filed this class action lawsuit, alleging violations of Washington's Consumer Protection Act, chapter 19.86 RCW, and Washington's usury statute, chapter 19.52 RCW, as well as negligence and breach of contract. AT&T removed the action to federal district court, claiming McKee had raised federal law in his complaint. After the complaint was amended to omit any reference to federal law, the federal court remanded the case back to Chelan County Superior Court.

AT&T then moved to compel arbitration under its Consumer Services Agreement. At the time McKee agreed to use AT&T as his long distance provider, he did not sign any agreement with AT&T and was not informed of any terms and conditions associated with AT&T service. After he began using AT&T, it sent him mail, which may have included a contract. He had not retained any of the mail and did not know the terms of his agreement with AT&T. In support of the motion to compel arbitration, AT&T employees Howard Spierer and April Morlock filed declarations averring that a specific agreement was sent to McKee in November as part of his

"fulfillment package" and attached a copy of that agreement to their declarations. We detail the specifics of the declarations because AT&T later repudiated the declarations it filed and the agreement it sought to enforce.

Spierer, a senior attorney with AT&T, signed a declaration on January 8, 2004, declaring that since August 1, 2001, AT&T's relationship with its customers has been governed by the terms of a Consumer Services Agreement. The Consumer Services Agreement has been revised several times. "Indeed, the version sent to Mr. McKee was an amended [Consumer Services Agreement], effective March 1, 2002." Clerk's Papers (CP) at 691. Morlock filed a similar declaration dated October 23, 2003, in support of AT&T's motion to compel arbitration. She declared,

1. I am a Fulfillment/Response Operations Manager for AT&T Corp.
2. It is my responsibility as a Fulfillment/Response Manager to ensure that all customers receive a "fulfillment package" from AT&T as a result of an order he/she may have placed. It is a business practice of AT&T to mail this fulfillment package within 8 -- 10 business days from the date the customer places his/her order . . . .
3. Mr. McKee became an AT&T customer in November 2002. Attached as Exhibit A to this declaration is a true and correct copy of the fulfillment package.

CP at 1114. Both Spierer and Morlock attached the same version of the Consumer Services Agreement, which became the subject of several hearings in Chelan County.

For clarity, an entire copy of the Consumer Services Agreement is included as an appendix to this opinion.<sup>1</sup> We focus primarily on the dispute

resolution provisions. Section 7 of the agreement, entitled "Dispute Resolution," requires binding arbitration of all disputes related to the agreement. It forbids class actions and requires that all arbitrations be kept confidential. The agreement also states in relevant part that "[n]o dispute may be joined with another lawsuit, or in an arbitration with a dispute of any other person, or resolved on a class-wide basis," and "[a]ny arbitration shall remain confidential. Neither you nor AT&T may disclose the existence, content, or results of any arbitration or award, except as may be required by law or to confirm and enforce an award." CP at 718-19. The dispute resolution section also provides that any claim must be brought within two years and limits a consumer's right to collect punitive damages and attorney fees.

McKee opposed the motion to compel arbitration and moved to stay arbitration, claiming the agreement was substantively and procedurally unconscionable. He claimed he had no meaningful choice and the agreement was overly one-sided and harsh because it prohibited class actions, shortened the statute of limitations, prohibited punitive damages and attorney fees, required arbitration be kept secret, and required application of New York law. AT&T is incorporated in New York. McKee filed declarations from a former Washington assistant attorney general and several other experienced Washington attorneys. Owen Clarke, former Washington State assistant attorney general for 25 years, and the head of the Spokane County Consumer Protection Division for 17 years, declared that McKee's class action suit would require a skilled attorney

and that without class certification the class members would be unable to retain qualified counsel. Two other experienced attorneys, Garfield Jeffers and David Thorner, declared that moderate income consumers cannot afford the hourly rates of trial lawyers and that no attorney would take a case on a contingent basis where the amount in controversy is so small and the risk so great.

On June 18, 2004, Judge Bridges heard oral argument on the motions to compel and stay arbitration. He denied the motion to compel arbitration, finding the entire dispute resolution section of the agreement substantively unconscionable because of the provisions prohibiting class actions, shortening the statute of limitations, limiting damages, requiring confidentiality, and requiring the application of New York law. Judge Bridges found the unconscionable provisions were not severable from other provisions and declared the entire dispute resolution clause unenforceable.

After Judge Bridges' oral ruling, more than a year passed before the parties presented findings of fact. It appears counsel was awaiting this court's decisions in *Zuver v. Airtouch Communications, Inc.*, 153 Wn.2d 293, 103 P.3d 753 (2004) and *Adler v. Fred Lind Manor*, 153 Wn.2d 331, 103 P.3d 773 (2004).

During that year, in March 2005, approximately nine months after the learned trial judge issued his oral opinion on June 18, 2004, Spierer filed a new declaration, declaring that AT&T had revised its Consumer Services Agreement for "its millions of residential customers." CP at 126-31. He declared that he was mistaken in his 2001 declaration. He contended that AT&T had amended its agreement "in significant ways, including, for example, the removal of the two-year statute of limitations, the ability of the customer to determine whether the proceedings should be confidential, and specifically allowing consumers to obtain statutory relief -- including damages and attorney's fees -- through the arbitration process."2 CP at 127. Spierer attached a revised draft of the AT&T Consumer Services Agreement that AT&T now contended was applicable to McKee.<sup>3</sup> AT&T moved for reconsideration and asked the court to consider this new version of the Consumer Services Agreement. When findings of fact and conclusions of law were finally presented to him, Judge Bridges expressed some frustration in the long delay, declined to sign either party's proposals, and instead adopted his oral ruling rendered more than one year earlier as his findings and conclusions. The judge also denied the motion for reconsideration and declined to consider a new version of the agreement.

AT&T appealed, and the Court of Appeals certified the case to this court. 4 The only Consumer Services Agreement considered by Judge Bridges was the March 1, 2002 agreement proffered by Spierer and Morlock on January 8, 2004 and October 23, 2003 respectively, and it is the only agreement before us for review.<sup>5</sup>

CHARGES, TERMS OR CONDITIONS, YOU AGREE TO THE CHANGES." CP at 719. Notice to the customer is described in section 1(b), "Increases to the prices or charges for the Services are effective no sooner than fifteen days after we post them on our Web site," and section 9, "With respect to all other changes to this Agreement, we will notify you of the changes, and they will be effective no sooner than fifteen days after we post them at

www.att.com/serviceguide/home. You may also request a copy of the revised Agreement . . . by calling AT&T toll free at 1-888-288-4099." Id.

### Standard of Review

Arbitrability is a question of law we review de novo. *Zuver*, 153 Wn.2d at 302. The burden of proof is on the party seeking to avoid arbitration. Id. (citing *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 92, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000)). When the validity of an agreement to arbitrate is challenged, courts apply ordinary state contract law. *Luna v. Household Fin. Corp.* III., 236 F. Supp. 2d 1166, 1173 (W.D. Wash. 2002) (quoting *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 892 (9th Cir. 2001)); see also *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 944, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995). General contract defenses such as unconscionability may invalidate arbitration agreements. *Luna*, 236 F. Supp. 2d at 1173 (quoting *Circuit City*, 279 F.3d at 892); see also *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996). Unconscionability is also a question of law we review de novo. *Nelson v. McGoldrick*, 127 Wn.2d 124, 131, 896 P.2d 1258 (1995). Choice of Law We turn first to the question of which state's law should apply to determine the validity of the agreement. Section 8(f) of AT&T's Consumer Services Agreement provides that New York law governs the agreement. Both the dispute resolution section and the agreement as a whole state that if any individual part is found unenforceable, it should be severed and the rest enforced. We review choice of law questions de novo. *Erwin v. Cotter Health Ctrs.*, 161 Wn.2d 676, 690-91, 167 P.3d 1112 (2007).

The choice of law question focuses us on very similar issues to those we considered in *Dix v. ICT Group, Inc.*, 160 Wn.2d 826, 161 P.3d 1016 (2007), where we held that a forum selection clause selecting the state of Virginia was substantively unconscionable because it effectively denied relief under Washington's Consumer Protection Act, which evidences a strong public policy in favor of class actions for small consumer claims.

We generally enforce contract choice of law provisions with certain exceptions. *Erwin*, 161 Wn.2d at 695-96. We disregard the contract provision and apply Washington law if, without the provision, Washington law would apply; if the chosen state's law violates a fundamental public policy of Washington; and if Washington's interest in the determination of the issue materially outweighs the chosen state's interest. Id. at 694-95 (citing *O'Brien v. Shearson Hayden Stone, Inc.*, 90 Wn.2d 680, 685, 586 P.2d 830 (1978) (quoting Restatement (Second) of Conflict of Laws § 187 (1971))). We will enforce a choice of law provision unless all three of these conditions are met.<sup>6</sup> Id. at 696.

Each of these conditions is met in this case. First, if there were no

<sup>6</sup>Additional exceptions to the general rule, not raised here, include when the issue is one that could have been provided for in an express agreement or when the state has no substantial relationship to the action and there is no other reasonable basis for the parties' choice. *Erwin*, 161 Wn.2d at 694 (citing Restatement, *supra*, § 187). choice of law provision, Washington law would be applied to this consumer contract performed in Washington. Washington applies the "most significant relationship" test from the Restatement, *supra*, § 188. *Mulcahy v. Farmers Ins. Co.*,

152 Wn.2d 92, 100, 95 P.3d 313 (2004). Courts weigh the relative importance to the particular issue of (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance of the contract, (d) the location of the subject matter of the contract, and (e) the domicile, residence, or place of incorporation of the parties. *Id.* (citing Restatement, *supra*, § 188). Here, Washington is the place of contracting, the place of negotiation (what little there was), the place of performance, the location of the subject matter, and the residence of one of the parties. New York's only tie to this litigation is that it is the state of incorporation of AT&T. We therefore conclude that, absent a choice of law clause, Washington law would apply to this dispute.

Second, New York law, which allows waiver of class-based relief, conflicts with our state's fundamental public policy to protect consumers through the availability of class action. See *Scott v. Cingular Wireless*, 160 Wn.2d 843, 854, 161 P.3d 1000 (2007); *Dix*, 160 Wn.2d at 829. Protecting parties in a position of weaker bargaining power from exploitation is among the types of fundamental public policy contemplated by Restatement, *supra*, § 187(2)(b) cmt. g.

The proper focus here, under section 187(2)(b) of the Restatement, is whether New York law permitting a class action ban is contrary to a Washington fundamental policy. This question is different than determining whether a class action ban under some circumstances is substantively unconscionable. We have held that some class action prohibitions may be conscionable. But application of New York law would permit waiver of any and all class action claims, and we have declared a strong Washington State public policy in support of the use of class action claims to pursue actions for small-dollar damage claims under the Washington State Consumer Protection Act. See *Scott*, 160 Wn.2d at 854.

In *Dix*, we explained that forum selection clauses contravening the "strong public policy of the forum in which suit is brought" may be invalid and we held that a forum selection clause designating Virginia as the forum was unenforceable against Washington citizens asserting small-dollar Consumer Protection Act claims. *Dix*, 160 Wn.2d at 836 (quoting *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15, 92 S. Ct. 1907, 32 L. Ed. 2d 513 (1972)). We held that a forum selection clause was substantively unconscionable because it denied relief by selecting a forum in which consumer class actions were not available. *Id.* at 837. Specifically, we held that "a forum selection clause that seriously impairs the plaintiff's ability to go forward on a claim of small value by eliminating class suits in circumstances where there is no feasible alternative for seeking relief violates public policy and is unenforceable." *Id.*

In contrast, New York courts have held that class action waivers are enforceable under New York law. *Tsadilas v. Providian Nat'l Bank*, 13 A.D.3d 190, 191, 786 N.Y.S.2d 478 (N.Y. App. Div. 2004); *Ranieri v. Bell Atl. Mobile*, 304 A.D.2d 353, 354, 759 N.Y.S.2d 448 (N.Y. App. Div. 2003). Under New York law, class-based relief would not be available in cases such as *Scott* and the one before us now. Therefore, the choice of New York law in this case is unconscionable under *Dix* because it conflicts with Washington's fundamental public policy favoring the availability of class-based relief for small consumer claims. Accordingly, we hold that Washington's strong Consumer Protection Act policy favoring class adjudication of small-dollar claims is a "fundamental policy" contemplated by Restatement, *supra*, § 187(2)(b).

Finally, Washington's interest in protecting large classes of its consumers materially outweighs New York's limited interest in this matter. See *Erwin*, 161 Wn.2d at 695. Thus, the New York choice of law provision in AT&T's Consumer Services Agreement is unenforceable and Washington law will be applied.

#### Federal Communications Act of 1934 Preemption

Next, AT&T argues that Washington law is preempted by the Federal Communications Act of 1934 (FCA) (codified as amended at 47 U.S.C. §§ 151-161, 201-231, 251-261, 301-339, 351-363). AT&T distinguishes this case from *Scott* because the federal act in question there was the Federal Arbitration Act (FAA), Title 9 U.S.C. *Scott*, 160 Wn.2d at 857-59. AT&T argues that the FCA "demonstrates a congressional intent that customers receive uniform terms and conditions of service" and that to achieve such uniformity, it is Congress's and the Federal Communications Commission's (FCC) goal to create a federal, uniform standard for determining the validity of the rates, terms, and conditions of carriers. AT&T contends that Washington's consumer protection and contract laws are impliedly preempted by the FCA because they "stand as an obstacle to the accomplishment and execution of Congress's and the FCC's purpose and objective of creating a federal, uniform standard for determining the validity of long-distance service contract rates, terms, and conditions." Br. of Appellant at 19-20.

Under the supremacy clause of the United States Constitution article VI, clause 2, state laws are not superseded by congressional legislation unless that is the clear and manifest purpose of Congress. *Hue v. Farmboy Spray Co.*, 127 Wn.2d 67, 78, 896 P.2d 682 (1995); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516, 112 S. Ct. 2608, 120 L. Ed. 2d 407 (1992). Preemption is a question of law we review de novo. *Axess Int'l Ltd. v. Intercargo Ins. Co.*, 107 Wn. App. 713, 722, 30 P.3d 1 (2001) (citing *Hoddevik v. Arctic Alaska Fisheries Corp.*, 94 Wn. App. 268, 278, 970 P.2d 828 (1999)). Conflict preemption is found where it is impossible to comply with both state and federal law or where state law "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248, 104 S. Ct. 615, 78 L. Ed. 2d 443 (1984) (citation omitted). The obstruction strand of conflict preemption focuses on both the objective of the federal law and the method chosen by Congress to effectuate that objective, taking into account the law's text, application, history, and interpretation. See *Int'l Paper Co. v. Ouellette*, 479 U.S. 481, 494, 107 S. Ct. 805, 93 L. Ed. 2d 883 (1987) ("state law . . . is pre-empted if it interferes with the methods by which the federal statute was designed to reach this goal"); *Jones v. Rath Packing Co.*, 430 U.S. 519, 526, 97 S. Ct. 1305, 51 L. Ed. 2d 604 (1977) (courts should consider how law is applied and interpreted in addition to plain text). Thus, the question for us is whether Congress's intent or goals would truly be frustrated if AT&T were required to comply with Washington's laws regarding the formation of consumer contracts and the strong public policy of Washington's Consumer Protection Act that consumers be able to vindicate their right to be free of unfair and deceptive practices in consumer transactions. See *Ting v. AT&T Corp.*, 319 F.3d 1126, 1136 (9th Cir. 2003) and cases cited therein. See also RCW 19.86.020.

AT&T urges us to follow a Seventh Circuit opinion that AT&T contends is the leading case on preemption under the FCA. *Boomer v. AT&T Corp.*, 309 F.3d 404 (7th Cir. 2002). The

Washington State attorney general, appearing as amicus, urges us not to follow Boomer. The attorney general argues the issue of whether the FCA preempts state consumer protection and contract laws was considered and correctly decided five years ago by the Ninth Circuit Court of Appeals in *Ting*, 319 F.3d 1126. The Ninth Circuit examined the FCA's text, application, history, and interpretation thoroughly before reaching its conclusion that the FCA, after detariffing, no longer preempts state laws in claims arising from the rates, terms, and conditions of a long distance carrier's customer contract. *Id.* at 1130-33, 1137-46.

Congress originally enacted the FCA in 1934, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C. §§ 151-161, 201-231, 251-261, 301-339, 351-363). It was passed in a monopolistic environment. Section 203(a) was intended to provide fair contracts through a tariff system. It required telecommunications carriers to file with the FCC a list of tariffs, or "schedules," showing "all charges . . . and . . . the classifications, practices, and regulations affecting such charges. 47 U.S.C. § 203(a). Tariffs covered not only the rates but the terms and conditions of customer contracts. The act prohibited any "classification, regulations, or practice affecting such charges, except as specified" in a carrier's filed tariffs. *Id.* § 203(2)(c). In the filed-tariff environment, consumers were, in theory, protected from unjust, unreasonable, or discriminatory rates, terms, and conditions by the FCC's prior determination that the carrier's filed rate was "just" and "reasonable" and not unreasonably or unduly discriminatory. Once a tariff was approved by the FCC, it then carried the force of law and became binding on both the consumer and the carrier. *Brown v. MCI Worldcom Network Servs., Inc.*, 277 F.3d 1166, 1170 (9th Cir. 2002) (citing *Lowden v. Simonds-Shields Lonsdale Grain Co.*, 306 U.S. 516, 520, 59 S. Ct. 612, 83 L. Ed. 953 (1939)). Under this regime, courts frequently held that state law contract claims were barred. See, e.g., *AT&T v. Cent. Office Tel., Inc.*, 524 U.S. 214, 228, 118 S. Ct. 1956, 141 L. Ed. 2d 222 (1998); *In re NOS Commc'ns*, 495 F.3d 1052 (9th Cir. 2007).

Over time, the monopolistic model fell way to deregulation and free market pressures. Under the old regime, AT&T had achieved a near monopoly in the telecommunications market, and there were many companies eager to enter the telecommunications market. Starting in the early 1980's, the FCC tried to prohibit tariff-filing by nondominant carriers (i.e., those other than AT&T) on the ground that market forces would guarantee reasonable rates without collusive pricing. In *Policy & Rules Concerning Rates for Competitive Common Carrier Servs.*, 99 F.C.C.2d 1020, 1028-29 (1985). Finally, in 1996, Congress fundamentally changed the communications act's scheme by adopting a national policy of opening all telecommunications markets to competition and providing a deregulatory, procompetition framework. H.R. Conf. Rep. No. 104-458, at 113 (1996), reprinted in 1996 U.S.C.C.A.N. 124. As the Ninth Circuit explained:

Finally armed with the requisite congressional authorization, the FCC promptly issued a Notice of Proposed Rulemaking on March 25, 1996, to "forbear from applying" the tariffing requirements of § 203 of the 1934 Act. Notice of Proposed Rulemaking, 11 F.C.C.R. 7,141 (1996). In the Notice, the Commission tentatively concluded that tariffs were no longer necessary because market forces were sufficient to protect consumers from unjust and unreasonable rates, terms, and conditions. *Id.* at ¶¶ 30, 31 (concluding that removing filing requirement will promote competition and prevent collusive pricing). Following a comment period, the FCC issued an order of mandatory detariffing on October 29, 1996, see Second Report and Order, 11 F.C.C.R. 20,730 (1996), thus confirming that "enforcement of the tariffing

provision is neither necessary to ensure just and reasonable, non-discriminatory rates, nor necessary for the protection of consumers." *MCI WorldCom, Inc., v. FCC*, 209 F.3d 760, 763 (D.C. Cir. 2000) (citing Second Report and Order, 11 F.C.C.R. 20,730, at ¶ 21).

*Ting*, 319 F.3d at 1132.

When Congress authorized the FCC to eliminate the filing requirement, it permitted the tariff filing mechanism to be replaced by a market-based mechanism in the form of individual negotiated contracts between carriers and their customers. *Id.* Unlike tariff filing, however, this market-based mechanism depends in part on state law. *Id.* at 1133. The market-based method of achieving the act's goals of reasonableness, fairness, and nondiscrimination in carrier contracts does not require a single, federal standard but rather depends in part on state law for the protection of consumers in the deregulated and competitive marketplace. *Id.*

The *Boomer* court, relied upon by AT&T, failed to do a historical analysis. *Boomer*, 309 F.3d at 417-23. The *Boomer* court based its conclusion upon a textual analysis of sections 201(b) and 202(a) of the 1996 Telecommunications Act. *Id.* Sections 201(b) and 202(a) of the act, which survived detariffing, require that charges and practices be "just and reasonable" and prohibit "unjust or unreasonable discrimination" in charges and practices. But as pointed out by the Ninth Circuit, "save for *Boomer*, no court has ever referred to § 201 or § 202 in declaring a carrier's tariff immune from state-law challenge. That role had always been reserved for § 203 and the filed rate doctrine." *Ting*, 319 F.3d at 1138 (citing *Cent. Office*, 524 U.S. at 223).<sup>8</sup>

The FCC no longer enforces section 203's filing requirements. We agree with the Ninth Circuit that reliance on sections 201 and 202 for federal preemption is untenable. *Ting*, 319 F.3d at 1139. Congress unquestionably intended that consumers receive fair and reasonable rates. 47 U.S.C. § 202(a) makes it unlawful for a carrier to "make any unjust or unreasonable discrimination" for "like communication service" or "to make or give any undue or unreasonable preference or advantage." But Congress also unquestionably intended that telecommunications providers compete in a free market place and that consumers would have the protection of state consumer protection laws.<sup>9</sup>

Senator Slade Gorton, then a senator from the state of Washington, succinctly summarized the goals of the FCA when he noted that the 1996 Telecommunications Act (permitting the FCC to cease enforcing section 203's tariffing requirement) would allow "[s]tates to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications service, and safeguard the rights of consumers, which are, of course, the precise goals of this Federal statute itself." 141 Cong. Rec. S8206-02, S8212 (daily ed. June 13, 1995) (statement of Sen. Gorton).<sup>10</sup>

Setting aside its preemption argument, even AT&T concedes that state law now governs the formation of consumer long distance contracts. *Br. of Appellant* at 22-23. This is so because even the *Boomer* court recognized that, following detariffing, there appears to be some role for state law. *Boomer*, 309 F.3d at 423 (acknowledging that state law may determine whether a contract has been formed). But we find no persuasive support for *Boomer's* argument that the role of state contract law is somehow limited to laws governing offer and acceptance. In *Marcus*

v. AT&T Corp., 138 F.3d 46, 54 (2d Cir. 1998), the court held that the communications act does not manifest a clear congressional intent to preempt state law prohibiting deceptive business practices, false advertising, or common law fraud. In interpreting the 1996 Telecommunications Act, the FCC has repeatedly referred to the role of state law and has not done so in limiting terms. See, e.g., In re Policy & Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Commc'ns Act of 1934, 11 F.C.C.R. 20,730, 20,751 (1996) (Second Report and Order) (after detariffing, consumers will also "be able to pursue remedies under state consumer protection and contract laws" and carriers will be treated like all other businesses in unregulated markets); In re Policy & Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Commc'ns Act of 1934, 12 F.C.C.R. 15,014, 15,057 (1996) (Order on Reconsideration) (consumers will have remedies under state contract and consumer protection law regarding the "legal relationship" between carrier and consumer).

To summarize, in 1996, Congress made a paradigm shift from a monopolistic, tariffed-rate system to a competitive market. Congress's goal of ensuring that telecommunications carriers provide consumers with reasonable, fair, and nondiscriminatory rates, terms, and conditions in a competitive market is furthered by providing consumers the protections of state contract and consumer protection laws. AT&T seems aghast that it may have to comply with the laws of 50 different states, but that is precisely what every other company that competes in a free, competitive, and open market must do. There is nothing in the 1996 Telecommunications Act that declares preemption or dictates that all contracts must be identical or uniform. 47 U.S.C. §§ 201, 202. Nothing prevents AT&T from creating new consumer services agreements with fair and reasonable terms that are consistent with the state laws in each state or all states in which it operates. Congress contemplated concurrent authority between federal and state authorities. State and private remedies aid rather than hinder the goal of preventing unjust or unreasonable discrimination.<sup>11</sup> We hold that the FCA does not preempt application of Washington law as to the validity of the contract.

#### FAA Preemption

AT&T also argues preemption under the FAA. As a preliminary matter, we reject AT&T's argument that unconscionability should be decided by the arbitrator under the FAA and *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006). In *Buckeye*, the plaintiff argued that the illegal interest rate provided for in the contract voided the entire contract, including the arbitration clause. *Id.* at 443-44. There was no argument that the arbitration clause itself was unconscionable or illegal. The court held that when a party claims the contract as a whole is illegal, but does not specifically challenge the arbitration clause, the arbitrator should decide whether the contract is illegal.

*Id.* at 449. The court did not change the rule that when the validity of the arbitration agreement itself is at issue, the courts must first determine whether there was a valid agreement to arbitrate. *Id.* at 445. That rule applies here because the challenges McKee raises with regard to the AT&T Consumer Services Agreement relate only and specifically to the dispute resolution and arbitration section. See *Preston v. Ferrer*, \_\_\_ U.S. \_\_\_, 128 S. Ct. 978, 984, 169 L. Ed. 2d 917 (2008) (court compelled arbitration under *Buckeye* because there was no discrete challenge to

the arbitration clause in the proceedings below); *Vasquez-Lopez v. Beneficial Or., Inc.*, 210 Or. App. 553, 565, 152 P.3d 940 (2007).

As in *Scott*, this challenge is not preempted by section 2 of the FAA. *Scott*, 160 Wn.2d at 858; 9 U.S.C. § 2. The FAA requires that we place arbitration agreements on the same footing as other contracts. See, e.g., *Doctor's Assocs.*, 517 U.S. at 687. It does not require us to allow unconscionable restrictions on arbitration that are essentially exculpatory clauses in disguise. The FAA does not require us to uphold a class action waiver merely because it is embedded in an arbitration agreement. See *Scott*, 160 Wn.2d at 858. Like any other contract, an arbitration agreement may be substantively unconscionable when it is used as a tool of oppression to prevent vindication of small but widespread claims. See, e.g., *id.* at 858-59; *Luna*, 236 F. Supp. 2d at 1179 (citing *Mendez v. Palm Harbor Homes, Inc.*, 111 Wn. App. 446, 465, 45 P.3d 594 (2002)).

As we said in *Scott*, class action waiver has nothing to do with a valid agreement to arbitrate. Class actions are often arbitrated. See *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 453, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003). Class actions actually promote the prime objective of an agreement to arbitrate, which is "streamlined proceedings and expeditious results." *Preston v. Ferrer*, \_\_\_ U.S. \_\_\_, 128 S. Ct. 978, 986, 169 L. Ed. 2d 917 (2008) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985)). Similarly, arbitrations can (and often should) be conducted openly and without secrecy, apply appropriate statutes of limitations, award damages (both compensatory and punitive), and award attorney fees. Limiting consumers' rights to open hearings, shortening statutes of limitations, limiting damages, and awarding attorney fees have absolutely nothing to do with resolving a dispute by arbitration. Courts will not be so easily deceived by the unilateral stripping away of protections and remedies, merely because provisions are disguised as arbitration clauses. The FAA does not require enforcement of unconscionable contract provisions. We adhere to our decision in *Scott* and hold that the FAA does not preempt application of Washington consumer protection law.

### Substantive Unconscionability

Although states may not refuse to enforce arbitration agreements based upon state laws that apply only to such agreements, "generally applicable contract defenses, such as fraud, duress, or unconscionability" may be applied. *Doctor's Assocs.*, 517 U.S. at 687. Whether an agreement is unconscionable is a question of law for the courts. *Nelson*, 127 Wn.2d at 131. Agreements may be either substantively or procedurally unconscionable. *Zuver*, 153 Wn.2d at 303. Substantive unconscionability involves those cases where a clause or term in the contract is one-sided or overly harsh. *Id.* Substantive unconscionability alone is sufficient to support a finding of unconscionability. *Adler*, 153 Wn.2d at 346-47. Here, the agreement to arbitrate is included in a section of the agreement entitled "Dispute Resolution." CP at 718-19. That section, and the rest of the agreement, contains several clauses limiting the nature of the relief available in arbitration.

### A. Class Action Waiver

This issue was largely, but not entirely, decided by *Scott*. *Scott*, 160 Wn.2d at 847. In *Scott*, we

held that a class action waiver in an arbitration agreement was substantively unconscionable. *Id.* In so holding, we relied on several crucial facts. First, the individual claims at issue were very small (between \$1 and around \$45 per month), but the plaintiffs alleged that in the aggregate, Cingular had overcharged the public very large sums of money. *Id.* at 847-48. We found that without class action suits, the public's ability to act as "private attorneys general," as intended in the Consumer Protection Act, was eviscerated. *Id.* at 854. We therefore concluded the class action waiver was unconscionably in violation of public policy. *Id.*

We also found the agreement substantively unconscionable because it effectively, if not explicitly, exculpated Cingular for potentially widespread misconduct. *Id.* at 855. We found that when wrongs are small but widespread, class actions are often the only effective way to address them. *Id.* We rejected Cingular's argument that relief was practically available because it promised to pay the costs of individual arbitration and because attorney fees could be awarded to the prevailing party. *Id.* at 856. We cited the evidence that no attorney would be willing to undertake individual arbitration to recover the trivial amounts of money at stake in an individual claim. *Id.* We also noted that small claims court was not an effective remedy because the amounts at issue were too small to be worth the time and energy, let alone the nominal filing fee. *Id.* We were concerned that without class actions, many consumers might not even know they had a claim. *Id.* at 855.

As in *Scott*, the contract now before us is a contract for consumer services, and the individual claims here are extremely small, under \$2 per month. Without access to class-wide relief, competent counsel would not be available to redress many meritorious claims. See CP at 566-69. The agreement allows for small claims court actions, but even the availability of small claims court or low-cost arbitration does not make it practicable for an individual to pursue such small amounts. See *Scott*, 160 Wn.2d at 855-56. Indeed, this agreement is less favorable to consumers than the one we struck down in *Scott*. Cingular's agreement at issue in *Scott* provided that Cingular would pay the attorney fees for a prevailing consumer. *Id.* at 856. Here, not only does AT&T not pay the consumer's attorney fees, the agreement prohibits the arbitrator from awarding them unless specifically provided for in a statute. Because the class action waiver in this case is not meaningfully different from the one we held substantively unconscionable in *Scott*, we hold that the class action waiver in the AT&T agreement before us is unconscionable.<sup>12</sup>

## B. Confidentiality

A confidentiality clause in a contract of adhesion is a one-sided provision designed to disadvantage claimants and may even help conceal consumer fraud. Confidentiality unreasonably favors repeat players such as AT&T. See *Ting*, 319 F.3d at 1151-52; *Luna*, 236 F. Supp. 2d at 1180; *Zuver*, 153 Wn.2d at 312-15. Secrecy conceals any patterns of illegal or abusive practices. It hampers plaintiffs in learning about potentially meritorious claims and serves no purpose other than to tilt the scales in favor of AT&T. See *Zuver*, 153 Wn.2d at 313-14. It ensures that AT&T will "accumulate[ ] a wealth of knowledge" about arbitrators, legal issues, and tactics. *Id.* at 312-13. Meanwhile, consumers are prevented from sharing discovery, fact patterns, or even work product, such as briefing, forcing them to reinvent the wheel in each

and every claim, no matter how similar.

Washington has a strong policy that justice should be administered openly and publicly. See *Dreiling v. Jain*, 151 Wn.2d 900, 908, 93 P.3d 861 (2004) (discussing sealed court records). Under our constitution, "[j]ustice in all cases shall be administered openly." Const. art. I, § 10. Secrecy breeds mistrust and, potentially, misuse of power. *Dreiling*, 151 Wn.2d at 908. Whether in regard to improper utility surcharges or unreasonably dangerous products, consumer adhesion contracts that require secrecy violate this important public policy. We hold that the confidentiality provision before us is substantively unconscionable.

### C. Statute of Limitations

Generally, parties can shorten the applicable statute of limitations by contract unless a shorter time frame is unreasonable or prohibited by statute or public policy. *Adler*, 153 Wn.2d at 356. But such a limitation is harsh and one-sided when imposed on a consumer in a contract of adhesion for a basic consumer service such as long distance telephone service. It is for these consumer service agreements that Washington's Consumer Protection Act is designed to provide protection. RCW 19.86.920 (purpose of act is to "protect the public and foster fair and honest competition"); see also *Scott*, 160 Wn.2d at 853. The Washington Consumer Protection Act provides a four year statute of limitations, but AT&T's agreement cuts that period in half. RCW 19.86.120; CP at 719. The four year statute of limitations permits adequate time for consumers to vindicate rights violated by unfair business practices. The act would be meaningless if consumer contracts of adhesion routinely stripped consumers of their remedies under the Consumer Protection Act; "consumers would have far less ability to vindicate" their rights under the act. *Scott*, 160 Wn.2d at 854. We hold AT&T's limitation on actions is substantively unconscionable as against public policy as to Consumer Protection Act claims. See *id.* at 851-53.

### D. Limit on Attorney Fees

The AT&T Consumer Services Agreement is completely lopsided on the issue of attorney fees. AT&T has not hesitated to give itself the advantage of collecting its attorney fees as one of its remedies. Section 2(e) of the agreement entitled "SUSPENDING AND CANCELLING THE SERVICES," provides in part, "Subject to Section 7, you must reimburse us for any reasonable costs we incur, including attorneys' fees, to collect charges owed to us." CP at 718. Section 3, entitled "INDEMNIFICATION," provides in part, "YOU AGREE TO REIMBURSE US FOR ALL COSTS AND EXPENSES RELATED TO THE DEFENSE OF ANY SUCH CLAIMS, INCLUDING ATTORNEYS' FEES." *Id.* However, section 7(a) provides that any claim by the customer must be submitted to arbitration and limits the remedies available, "THE ARBITRATOR MAY NOT AWARD DAMAGES THAT ARE NOT EXPRESSLY AUTHORIZED BY THIS AGREEMENT AND MAY NOT AWARD PUNITIVE DAMAGES OR ATTORNEYS' FEES UNLESS SUCH DAMAGES ARE EXPRESSLY AUTHORIZED BY A STATUTE." *Id.*

Section 7 contravenes the policy of this state. Washington follows the American rule, and each party is expected to pay the party's own attorney fees unless otherwise provided by statute or contract. *Cosmopolitan Eng'g Group, Inc. v. Ondeo Degremont, Inc.*, 159 Wn.2d 292, 303, 149

P.3d 666 (2006). When one party to a contract seeks to impose a unilateral attorney fee provision by contract, Washington's policy, by statute, is to convert the unilateral provision into a reciprocal contractual provision that applies equally to all parties to the contract. RCW 4.84.330. Further Washington's Consumer Protection Act provides for attorney fees for consumers who successfully challenge unfair acts and practices. RCW 19.86.090. AT&T's provision limiting attorney fees is unconscionable under Scott. We found that even if attorney fees might be awarded to a prevailing consumer, the risk was still too great to make relief meaningfully available. Scott, 160 Wn.2d at 856. If an arbitrator awarded even one cent less than the amount the consumer requested (which arbitrators often do in attempting to find a compromise), the attorney fees would not be available. Id. Here, the agreement purports to prohibit the arbitrator from awarding attorney fees unless expressly provided for in a statute. CP at 718. We hold the limit on attorney fees is also substantively unconscionable.

#### E. Limit on Punitive Damages

As described above, section 7 prohibits an arbitrator from awarding punitive damages unless expressly authorized by statute. The trial judge concluded that this provision was substantively unconscionable. However, Washington is one of only a few states that does not provide generally for punitive damages for particularly egregious conduct. Dailey v. N. Coast Life Ins. Co., 129 Wn.2d 572, 575, 919 P.2d 589 (1996); see also, e.g., Allowance of Punitive Damages in Products Liability Case, 13 A.L.R.4th 52 (1982). Washington does provide a few limited examples of exemplary damages. The relevant example is the Consumer Protection Act, which provides "treble" damages upon appropriate findings. RCW 19.86.090. We say limited because in the instant case, the damages sought are \$2 per month; under Washington's Consumer Protection Act, a prevailing consumer might be awarded up to \$6 per month. The agreement permits punitive damages "expressly authorized by a statute." CP at 718. Because Washington provides for limited examples of exemplary damages and each example is specifically authorized by statute, we do not read AT&T's Consumer Services Agreement to limit the availability of punitive damages in Washington State. We hold the limitation on punitive damages is not unconscionable.

#### Procedural Unconscionability

The trial judge found AT&T's Consumer Services Agreement both substantively and procedurally unconscionable. McKee was not provided with a copy of any agreement at the time he signed up for AT&T services. Even when a consumer contracts for a service electronically, the consumer has an opportunity to review the contract and is given the choice to "agree" before the contract is formed. See, e.g., Koresko v. RealNetworks, Inc., 291 F. Supp. 2d 1157, 1163 (E.D. Cal. 2003) (describing electronic "clickwrap" agreements). AT&T apparently mailed the terms and conditions to McKee 10 days to two weeks after he subscribed for service. AT&T retained the right to unilaterally change the contract by posting the change on its web site or by mailing the notice of the change. A consumer was deemed to have agreed to the changes by continuing to use AT&T service whether the consumer had actual notice of the change or not.<sup>13</sup> At no time was the consumer required to read and sign or affirmatively acknowledge acceptance of the terms and conditions. These facts raise an issue of whether McKee had a reasonable opportunity to understand the terms and a meaningful choice. See Zuver, 153 Wn.2d at 304.

However, having held below that the entire dispute resolution provision is substantively unconscionable, we find it unnecessary to reach the issue of procedural unconscionability.

### Severability

The trial judge concluded these unconscionable provisions permeate the entire arbitration agreement and thus cannot be severed. Each provision discussed above magnifies the exculpatory effect of the arbitration agreement. These unconscionable provisions operate in concert to eliminate any realistic possibility of relief for consumers with small claims such as McKee's. We affirm Judge Bridges's conclusion that severance is not possible because the four unconscionable terms pervade the dispute resolution section of the agreement. AT&T would have us strike the unconscionable provisions from the dispute resolution section and enforce the rest of the dispute resolution section. However, when unconscionable provisions so permeate an agreement, we strike the entire section or contract. See *Zuver*, 153 Wn.2d at 320 (quoting *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1180 (9th Cir. 2003); *Alexander v. Anthony Int'l, LP*, 341 F.3d 256, 271 (3d Cir. 2003)). Here, we are faced with four different unconscionable terms and we find that they taint the entire dispute resolution section, such that severance would essentially require us to rewrite the dispute resolution agreement. See *Ingle*, 328 F.3d at 1180.

Permitting severability as requested by AT&T in the face of a contract that is permeated with unconscionability only encourages those who draft contracts of adhesion to overreach. If the worst that can happen is the offensive provisions are severed and the balance enforced, the dominant party has nothing to lose by inserting one-sided, unconscionable provisions.

Although we find that the entire dispute resolution section must be stricken because the unconscionable terms are inextricable without rewriting the agreement, we find that this effect does not extend to the rest of the Consumer Services Agreement. Section 8 of the Consumer Services Agreement provides for severability. "e. Separability. If any part of this Agreement is found invalid, the rest of the Agreement will remain valid and enforceable." CP at 719. We give effect to severability clauses if we can easily excise the unconscionable provision without essentially rewriting the contract. See *Zuver*, 153 Wn.2d at 320 (citing *Ingle*, 328 F.3d at 1180). We find that having excised the dispute resolution provision as unconscionable, the balance of the agreement stands on its own. We hold that the balance of the agreement is enforceable subject to this opinion. 14

**Outcome:** Courts, not arbitrators, decide the validity of arbitration agreements. *Buckeye*, 546 U.S. at 445. Applying choice of law principles, Washington law applies to this contract dispute. Washington consumer protection law and Washington law relating to the formation of contracts are not preempted by either the FCA or the FAA. The AT&T Consumer Services Agreement before us is a contract of adhesion. AT&T's Consumer Services Agreement is substantively unconscionable and therefore unenforceable to the extent that it purports to waive the right to class actions, require confidentiality, shorten the Washington Consumer Protection Act statute of limitations, and limit availability of attorney fees. We emphasize that these provisions have nothing to do with arbitration. Arbitrators supervise class actions, conduct open hearings, apply appropriate statutes of limitations, and award compensatory and punitive damages, as well as attorney fees, where appropriate. Courts will not be easily deceived by attempts to unilaterally

strip away consumer protections and remedies by efforts to cloak the waiver of important rights under an arbitration clause. The dispute resolution section is severable from the balance of the contract. We affirm the trial court in all respects unless otherwise noted and remand for further proceedings consistent with this opinion.

This case is against talk America about TOS which also involves an arbitration clause.

United States Court of Appeals,  
Ninth Circuit.

Joe DOUGLAS, on behalf of himself and on behalf of all others similarly situated, Petitioner,  
v.

UNITED STATES DISTRICT COURT FOR the CENTRAL DISTRICT OF CALIFORNIA,  
Respondent,

Talk America Inc., a Pennsylvania corporation, Real Party in Interest.

No. 06-75424.

Argued and Submitted June 7, 2007.

Filed July 18, 2007.

**Background:** Customer filed class action against long distance telephone service provider, alleging violations of Federal Communications Act (FCA) and various state law consumer protection statutes, and breach of contract for changing terms of service contract by posting revised contract on website but not otherwise notifying customers. Customer petitioned for writ of mandamus after the United States District Court for the Central District of California granted provider's motion to compel arbitration, under Federal Arbitration Act (FAA).

**Holdings:** The Court of Appeals held that:

- (1) customer was not bound by revised terms of contract;
- (2) customer lacked other adequate means of challenging arbitration order and would be prejudiced in manner not correctable on appeal; and
- (3) arbitration order addressed issue of first of impression and raised new and important problems.

Petition granted.

[Paul F. Donsbach](#) and [Jennifer L. Andrews](#), Kutak Rock LLP, Irvine, CA; [Bartholomew L. McLeay](#), [Jeremy Fitzpatrick](#) and [Paul R. Gwilt](#), Kutak Rock LLP, Omaha, NE, for real party in interest.

On Petition for Writ of Mandamus to the United States District Court for the Central District of California. D.C. No. CV-06-03809-GAF.

Before: [ALEX KOZINSKI](#), [RONALD M. GOULD](#) and [CONSUELO M. CALLAHAN](#), Circuit Judges.

PER CURIAM:


\*\*1 We consider whether a service provider may change the terms of its service contract by merely posting a revised contract on its website.

### Facts

Joe Douglas contracted for long distance telephone service with America Online. Talk America subsequently acquired this business from AOL and continued to provide telephone service to AOL's former customers. Talk America then added four provisions to the service contract: (1) additional service charges; (2) a class action waiver; (3) an arbitration clause; and (4) a choice-of-law provision pointing to New York law. Talk America posted the revised contract on its website but, according to Douglas, it never notified him that the contract had changed. Unaware of the new terms, Douglas continued using Talk America's services for four years.

After becoming aware of the additional charges, Douglas filed a class action lawsuit in district court, charging Talk America with violations of the Federal Communications Act, breach of contract and violations of various California consumer protection statutes. Talk America moved to compel arbitration based on the modified contract and the district court granted the motion. Because the Federal Arbitration Act, [9 U.S.C. § 16](#), does not authorize interlocutory appeals of a district court order compelling arbitration, Douglas petitioned for a writ of mandamus.

### Analysis

[\[1\]](#)  Because a writ of mandamus is an extraordinary remedy, we have developed five factors that cabin our power to grant the writ:

1. “The party seeking the writ has no other adequate means, such as a direct appeal, to attain the relief he or she desires.”
2. “The petitioner will be damaged or prejudiced in a way not correctable on appeal.”
- \*1066 3. “The district court's order is clearly erroneous as a matter of law.”
4. “The district court's order is an oft-repeated error, or manifests a persistent disregard of the federal rules.”
5. “The district court's order raises new and important problems, or issues of law of first impression.”

[Bauman v. U.S. Dist. Court, 557 F.2d 650, 654-55 \(9th Cir.1977\).](#)

The third factor is a necessary condition for granting a writ of mandamus. [Executive Software N. Am., Inc. v. U.S. Dist. Court, 24 F.3d 1545, 1551 \(9th Cir.1994\)](#). But “all five factors need not be satisfied at once.” [Valenzuela-Gonzalez v. U.S. Dist. Court, 915 F.2d 1276, 1279 \(9th Cir.1990\)](#). If the district court clearly erred, we determine whether the four additional factors “in the mandamus calculus point in favor of granting the writ.” [Executive Software, 24 F.3d at 1551](#).

[2] [3] [4] [5] [6] 1. Douglas alleges that Talk America changed his service contract without notifying him. He could only have become aware of the new terms if he had visited Talk America's website and examined the contract for possible changes. The district court seems to have assumed Douglas had visited the website when it noted that the contract was available on “the web site on which Plaintiff paid his bills.” However, Douglas claims that he authorized AOL to charge his credit card automatically and Talk America continued this practice, so he had no occasion to visit Talk America's website to pay his bills. Even if Douglas had visited the website, he would have had no reason to look at the contract posted there. 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.<sup>FN1</sup> Indeed, a party can't unilaterally change the terms of a contract; it must obtain the other party's consent before doing so. [Union Pac. R.R. v. Chi., Milwaukee, St. Paul & Pac. R.R., 549 F.2d 114, 118 \(9th Cir.1976\)](#). This is because a revised contract is merely an offer and does not bind the parties until it is accepted. [Matanuska Val Farmers Cooperating Ass'n v. Monaghan, 188 F.2d 906, 909 \(9th Cir.1951\)](#). And generally “an offeree cannot actually assent to an offer unless he knows of its existence.” [1 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 4:13, at 365 \(4th ed.1990\)](#); see also [Trimble v. N.Y. Life Ins. Co., 234 A.D. 427, 255 N.Y.S. 292, 297 \(1932\)](#) (“An offer may not be accepted until it is made and brought to the attention of the one accepting.”). Even if Douglas's continued use of Talk America's service could be considered assent, such assent can only be inferred after he received proper notice of the proposed changes. Douglas claims that no such notice was given.

<sup>FN1</sup>. Nor would a party know *when* to check the website for possible changes to the contract terms without being notified that the contract has been changed and how. Douglas would have had to check the contract every day for possible changes. Without notice, an examination would be fairly cumbersome, as Douglas would have had to compare every word of the posted contract with his existing contract in order to detect whether it had changed.

\*\*2 [Crawford v. Talk America, Inc., No. 05-CV-0180-DRH, 2005 WL 2465909, at \\*4 \(S.D.Ill. Oct. 6, 2005\)](#), and [Bischoff v. DirecTV, Inc., 180 F.Supp.2d 1097, 1103-06 \(C.D.Cal.2002\)](#), on which the district court relied, are not to the contrary. The customers in these cases received notice of the modified contract by mail. The service provider in [Bischoff](#) mailed the contract to the customer, [180 F.Supp.2d at 1101](#), and the service provider in [Crawford](#) gave notice to the customer that she could see the contract terms online or call the service provider to learn of the terms. [2005 WL 2465909, at \\*3 n. 3](#). Furthermore, \*1067 [Crawford](#) and [Bischoff](#) involved new customers who necessarily would be on notice that they were required to assent to

contract terms as a predicate for using the service. By contrast, the California Court of Appeal has held that a *revised* contract containing an arbitration clause is unenforceable against existing customers, even when they are given notice by mail. [Badie v. Bank of Am.](#), 67 Cal.App.4th 779, 801, 79 Cal.Rptr.2d 273 (1998).

[7] [8] [9] [10] [11] The district court thus erred in holding that Douglas was bound by the terms of the revised contract when he was not notified of the changes. The error reflects fundamental misapplications of contract law and goes to the heart of petitioner's claim. It would alone be sufficient to satisfy the third [Bauman](#) factor, but the district court also committed two additional errors. Even if Douglas were bound by the new terms of the contract (which he is not for the reasons already explained), the new terms probably would not be enforceable in California because they conflict with California's fundamental policy as to unconscionable contracts.<sup>FN2</sup> In New York, as in California, a contract is unconscionable only if it is both procedurally and substantively unconscionable. See [Armendariz v. Found. Health Psychcare Servs., Inc.](#), 24 Cal.4th 83, 114, 99 Cal.Rptr.2d 745, 6 P.3d 669 (2000); [Gillman v. Chase Manhattan Bank, N.A.](#), 73 N.Y.2d 1, 10, 537 N.Y.S.2d 787, 534 N.E.2d 824 (1988). That's where the similarities end. The district court erred in analyzing California law as to both procedural and substantive unconscionability.

FN2. Under the Federal Arbitration Act (FAA), [9 U.S.C. § 2](#), “[a]rbitration agreements ... are subject to all defenses to enforcement that apply to contracts generally.” [Ingle v. Circuit City Stores, Inc.](#), 328 F.3d 1165, 1170 (9th Cir.2003). Thus, “[t]o evaluate the validity of an arbitration agreement, federal courts ‘should apply ordinary state-law principles that govern the formation of contracts.’ ” *Id.* (quoting [First Options of Chicago, Inc. v. Kaplan](#), 514 U.S. 938, 944, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995)). Such state-law principles come from the law of a particular state-not federal general common law under the FAA. See [First Options](#), 514 U.S. at 944, 115 S.Ct. 1920. Here, Douglas has raised the state law defenses of lack of contract formation and unconscionability, so we must determine which state's law applies.

The FAA “does not create any independent federal-question jurisdiction.” [Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.](#), 460 U.S. 1, 25 n. 32, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). The district court exercised supplemental jurisdiction in this case. When a federal court exercises supplemental jurisdiction, “the federal court applies the choice-of-law rules of the forum state,” which in this case is California. [Paracor Fin., Inc. v. Gen. Elec. Capital Corp.](#), 96 F.3d 1151, 1164 (9th Cir.1996).

Under California's choice-of-law rules, the district court may not enforce the choice-of-law provision pointing to New York law if (1) New York's substantive law is contrary to a fundamental policy entrenched in California's substantive law and (2) California has a “materially greater interest” than New York in determining the issue. [Wash. Mut. Bank, FA v. Superior Court](#), 24 Cal.4th 906, 916-17, 103 Cal.Rptr.2d 320, 15 P.3d 1071 (2001) (quoting [Restatement \(Second\) of Conflict of Laws § 187\(2\)](#)). To determine which state has the materially greater interest, we look to the domicile of the parties and the place of the wrong. See [Reich v. Purcell](#), 67 Cal.2d 551, 555, 63 Cal.Rptr. 31, 432 P.2d 727 (1967). California certainly has an interest in protecting the thousands of citizens in the California subclass of this class action from

unconscionable contracts. And this interest is materially greater than New York's interest because Talk America is a Pennsylvania corporation with its principal place of business in Pennsylvania. Therefore, if New York law conflicts with a fundamental policy of California, the choice-of-law provision cannot be enforced and California law would apply.

[12] [13] The district court held that the arbitration clause in the modified contract is not procedurally unconscionable (and therefore enforceable) because Douglas had meaningful alternative choices for telephone\*1068 service. Under New York law this choice forecloses any procedural unconscionability claim. See [Ranieri v. Bell Atl. Mobile, 304 A.D.2d 353, 759 N.Y.S.2d 448, 449 \(2003\)](#). However, after the district court made its ruling, we noted that California “has rejected the notion that the availability ... of substitute ... services *alone* can defeat a claim of procedural unconscionability.” [Nagrampa v. MailCoups, Inc., 469 F.3d 1257, 1283 \(9th Cir.2006\)](#) (en banc). In California, a contract can be procedurally unconscionable if a service provider has overwhelming bargaining power and presents a “take-it-or-leave-it” contract to a customer-even if the customer has a meaningful choice as to service providers. [Id. at 1284](#).

\*\*3 [14] [15] Likewise, the district court held that the class action waiver provision is not substantively unconscionable. Such waivers aren't substantively unconscionable under New York law. See [Hayes v. County Bank, 26 A.D.3d 465, 811 N.Y.S.2d 741, 743 \(2006\)](#); [Tsadilas v. Provident Nat'l Bank, 13 A.D.3d 190, 786 N.Y.S.2d 478, 480 \(App.Div.2004\)](#); [Ranieri, 759 N.Y.S.2d at 449](#). The district court cited [Provencher v. Dell, Inc., 409 F.Supp.2d 1196, 1201 \(C.D.Cal.2006\)](#), for the proposition that California law was in accord, but the California Court of Appeal in [Cohen v. DirecTV, Inc., 142 Cal.App.4th 1442, 1455 n. 13, 48 Cal.Rptr.3d 813 \(Ct.App.2006\)](#), expressly disavowed [Provencher](#). A class action waiver provision thus may be unconscionable in California. Whether it is depends on the facts and circumstances developed during the course of litigation. The district court clearly erred in holding that the clauses (assuming that they are part of the contract at all) are consistent with California policy and therefore enforceable as a matter of law.

Because we find that the district court committed clear errors of law, we turn to the remaining four [Bauman](#) factors.

[16] [17] 2. The first and second [Bauman](#) factors weigh in favor of granting mandamus relief.<sup>FN3</sup> If Douglas is forced to arbitrate, he “has no other adequate means” of ensuring that he can continue as the class representative. [Bauman, 557 F.2d at 654](#). This would “prejudice [ ]” Douglas “in a way not correctable on appeal.” [Id.](#)


FN3. We generally examine the first and second factors together. See [Bauman, 557 F.2d at 654](#) (the second factor “is closely related to the first”).

If Douglas wins the arbitration and is awarded all the damages he asks for, then his individual claim would be rendered moot.<sup>FN4</sup> Douglas couldn't avoid mootness by moving to vacate the arbitration award solely because he wanted to continue as the class representative. There are only four permissible grounds for vacating an arbitration award: (1) “the award was procured by corruption, fraud, or undue means”; (2) “there was evident partiality or corruption in the

arbitrators”; (3) the arbitrators “refus[ed] to postpone the hearing” even when there was sufficient cause to postpone, “refus[ed] to hear evidence pertinent and material to the controversy” or engaged in “other misbehavior”; and (4) “where the arbitrators exceeded their powers.” [9 U.S.C. § 10\(a\)](#). In sum, a party needs to show “affirmative misconduct” or “irrational[ity]” in the arbitration \*1069 to vacate an arbitration award. [Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.](#), 341 F.3d 987, 998 (9th Cir.2003) (en banc). Losing the opportunity to continue as a class representative doesn't come close to meeting this standard.

[FN4](#). If Douglas were to lose the arbitration or were awarded less than he seeks, his claim would not be moot, as he would be able to challenge the district court's order compelling arbitration as part of his appeal of the arbitration award. See [Sanford v. MemberWorks, Inc.](#), 483 F.3d 956, 960 (9th Cir.2007) (reversing a district court's order compelling arbitration when the plaintiff received an arbitration award on a restitution claim but “[t]he arbitrator found for [defendant] on [plaintiff's] other claims”).

If Douglas's individual claim is rendered moot because it is fully satisfied as a result of the arbitration, he would lose his status as class representative because he would no longer have a concrete stake in the controversy. It is also doubtful that he could appeal the district court's order confirming an award that fully satisfied his individual claim, and he would thus have no opportunity to challenge the district court's order compelling the arbitration in the first place. It is thus entirely possible that the district court's clear error in compelling arbitration would be insulated from appellate review. [Bauman](#), 557 F.2d at 654.

\*\*4 [\[18\]](#)  3. The fifth [Bauman](#) factor also favors mandamus relief. The district court's order enforcing new contractual terms when a customer is only given notice of the terms by having the contract posted on the internet “raises new and important problems” and addresses “issues of law of first impression.” [Bauman](#), 557 F.2d at 655. This is the first time any federal court of appeals has considered whether to enforce a modified contract with a customer where the customer claims that the only notice of the changed terms consisted of posting the revised contract on the provider's website. This issue is also of some significance, as it potentially affects the relationship of numerous service providers with millions of customers, and thus deserves immediate resolution.

\* \* \*

Because four of the five [Bauman](#) factors favor mandamus relief, and only one factor (the fourth) militates against it, we conclude that the balance of factors favors issuing the writ. The district court's order compelling arbitration is vacated.

**PETITION GRANTED.**