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Enforcing Modified Contracts: Notification and Assent

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In a recent class action lawsuit (*Douglas v. United States District Court*) the Court of Appeals ruled that a customer cannot be bound by the modified terms of a service contract if they did not receive proper notice of the modifications. Because many Internet-based businesses rely on statements making the customer liable for checking for updates to contract terms, the Court of Appeals' decision could have ramifications for e-finance and e-payments companies that conduct their business online, explain Mark R. Weinstein and Heidi L. Keefe of White & Case.

The Case

Sometime after plaintiff Joe Douglas entered into a contract for a telephone service with America Online (AOL), Talk America acquired AOL's telephone service business. Talk America continued to provide service to AOL's former customers, but decided to change the terms of the AOL service contract by adding four provisions:

- A provision specifying additional service charges
- An agreement prohibiting its customers from participating in class action lawsuits

- A provision requiring that disputes be resolved through arbitration and not through the courts
- A choice-of-law provision requiring application of New York law.

Talk America posted the revised contract on its website but, according to Mr. Douglas, did not notify its customers that the contract terms had changed. In addition, many Talk America customers, including Mr. Douglas, remained unaware of the new contract terms because they had no occasion to visit the Talk America website. When he had originally signed up for the telephone service with AOL, Mr. Douglas authorized AOL to automatically charge his credit card for service fees. Talk America continued this practice after it acquired AOL's telephone service business, so Mr. Douglas was never required to login to the Talk America website to use his telephone service or to pay his bills. Unaware of the new contract terms, Mr. Douglas continued to use Talk America's services for several years.

After Mr. Douglas became aware of the new charges, he filed a class action lawsuit against Talk America in the United States District Court, Central District of California. The lawsuit accused Talk America of violations of the Federal



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Communications Act, breach of contract and violations of various consumer protection statutes. Talk America responded by filing a motion to compel Mr. Douglas to submit the dispute to arbitration based on the modified contract terms. The trial court agreed with Talk America and ordered arbitration. Mr. Douglas then filed a petition with the US Court of Appeals for the Ninth Circuit to challenge the decision.

The Court of Appeals Decision

The Court of Appeals sided with Mr. Douglas and reversed the trial court's decision to order arbitration. The court concluded that Mr. Douglas was not bound by the modified terms of the service contract because he did not receive proper notice of the modifications. The court held that the revised contract terms posted on Talk America's website were 'merely an offer' that could not bind customers unless they manifested assent to the changes. 'Parties to a contract,' it stated, 'have no obligation to check the terms on a periodic basis to learn whether they have been changed by the other side. Indeed, a party can't unilaterally change the terms of a contract; it must obtain the other party's consent before doing so.' According to the Court of Appeals, the trial court's decision reflected 'fundamental misapplications of contract law.' The court expressed no opinion as to whether assent could have been inferred if Mr. Douglas received notice of the contract changes and then continued to use Talk America's services. 'Even if Douglas's continued use of Talk America's service could be considered assent,' the court stated, 'such assent can only be inferred after he received proper notice of the proposed changes. Douglas claims that no such notice was given.'

Implications of the Decision

In agreeing to hear the appeal, the Court of Appeals recognized the potential significance of the case. The court noted that '[t]his 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.' The court stated that '[t]his 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.' Although the appellate court's decision does not cover the entire United States, it does cover all nine of the western states including the bellwether technology states of California, Washington and Oregon.

The Ninth Circuit Court's decision could affect millions of contractual arrangements formed on the Internet

Because many web-based service providers rely on statements such as: 'we may change our Terms of Use at any time. You are responsible for checking these terms periodically for changes,' the Ninth Circuit Court's decision could affect millions of contractual arrangements formed on the Internet. The Douglas decision flatly rejects this passive approach to notification and requires companies to provide notice to each customer individually. Such notice can be provided, for example, by sending the new contract terms to each customer through electronic and/or postal mail. Companies that provide online services may also consider requiring users to assent to modified terms through user interfaces similar to those used in 'clickwrap' license agreements. In a typical clickwrap agreement, the new contract terms are presented on the customer's computer screen and the customer must click 'I AGREE' before he is allowed to resume use of the service. To the extent feasible, companies should also make efforts to identify the precise changes to their service contracts, so that their customers are not forced to undertake cumbersome word-for-word comparisons.

The appellate court's decision also calls into question the validity of 'browsewrap' agreements which are used by hundreds of thousands (if not millions) of

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websites. With a typical browsewrap agreement, terms and conditions of use are made available through a hyperlink on each page of a website, but the user is not required to view the terms before using the site. Over the past several years, an increasing number of courts in the United States have enforced browsewrap agreements, even where the user did not know about the terms. The Douglas decision, however, could be interpreted as an outright rejection of such agreements. Service providers will likely argue for a narrow interpretation of the Douglas decision in order to avoid such a result. For example, they might emphasize that Mr. Douglas contracted for telephone service which, by its nature, required no access to a website. Indeed, Mr. Douglas used Talk America's telephone services for years without ever having to visit the company's website. If this distinction is successfully drawn, a later court might find that the Douglas decision does not apply where a company provides its services 'through' a website where the contract terms are constantly and readily available. Putting aside projections for the specific implications of the Douglas decision,

one thing remains certain: This decision will likely rekindle the long-running debate on how courts should approach the formation and enforcement of contracts in cyberspace.

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