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District Court in Texas Rejects Online Terms of Service as Illusory and Unenforceable

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On April 15, 2009, a Texas federal district court held that an arbitration provision in Blockbuster's online terms of service was "illusory" and unenforceable because Blockbuster had reserved the right to change the terms of service at any time. *Harris v. Blockbuster Inc.*, No. 3:09-cv-217-M (N.D. Tex. April 15, 2009). If followed by other courts, the *Harris* decision could have significant implications not only for website operators, but also for any company that wishes to retain the right to modify its standard terms for existing customers.

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The *Harris* Decision

Harris arose out of Blockbuster's participation in Facebook's "Beacon" program, through which the movie rental choices of Facebook users were disseminated to such users' Facebook friends. The plaintiff, Cathryn Harris, claimed that, by participating in the Beacon program, Blockbuster violated the Video Privacy Protection Act, 18 U.S.C. § 2710, which prohibits a videotape service provider from disclosing personally identifiable information about a customer without the customer's informed, written consent. Blockbuster attempted to invoke an arbitration provision in its standard "Terms and Conditions of Use," to which Harris had agreed by clicking a box when she registered to use the Blockbuster online service. Harris, however, argued that the arbitration provision was unenforceable because it was illusory.

Harris's argument was based on the fact that Blockbuster had reserved for itself the unilateral right to modify its Terms and Conditions of Use, as follows:

> Blockbuster may at any time, and at its sole discretion, modify these Terms and Conditions of Use, including without limitation the Privacy Policy, with or without notice. Such modifications will be effective immediately upon posting. You agree to review these Terms and Condition of Use periodically and your continued use of this Site following such modifications will indicate your acceptance of these modified Terms and Conditions of Use. If you do not agree to any modification of these Terms and Conditions of Use, you must immediately stop using this Site.

The court noted that a previous Fifth Circuit case, *Morrison v. Amway Corp.*, 517 F.3d 248 (5th Cir.

2008), had involved a similar challenge to an arbitration provision and that the *Morrison* court had found the arbitration provision illusory under Texas law because "[t]here is no express exemption of the arbitration provisions from Amway's ability to unilaterally modify all rules, and the only express limitation on that unilateral right is published notice." The *Morrison* court was particularly concerned that nothing in Amway's standard terms prevented Amway from modifying the arbitration provision and applying it even to claims that arose prior to the modification – exactly what Amway was attempting to do in *Morrison*. The *Morrison* court distinguished its case from an earlier Texas case, *In re Halliburton Co.*, 80 S.W.3d 566 (Tex. 2002), in which the Texas Supreme Court rejected the argument that an arbitration provision in an employment policy was unenforceable based on the employer's unilateral right to modify the policy. *Halliburton* was different, the *Morrison* court held, because the employer's right to modify the policy was expressly prospective; the employer did not attempt to reserve to itself the right to make changes that were applicable retroactively.

Based on the *Morrison* precedent, the district court in *Harris* held that the Blockbuster arbitration provision was illusory. The court noted that, as was the case in *Morrison*, nothing in the Blockbuster Terms and Conditions of Use expressly prevented Blockbuster from making modifications to the arbitration provision and applying the modified terms to earlier disputes. Blockbuster argued that, unlike Amway in *Morrison*, Blockbuster was not actually trying to apply a modified arbitration provision to a prior claim. The *Harris* court rejected this distinction, however, holding that it was not Amway's attempt to apply the arbitration provision retroactively that made the provision illusory in *Morrison*; rather, it was the fact that Amway had reserved for itself the right to change the rules at any time: "The Court . . . finds that the *Morrison* rule applies even when no retroactive modification has been attempted."

Implications of *Harris*

The *Harris* decision is surprising in that, based only on the presence of the unilateral modification clause, it invalidates an arbitration provision that the user clearly agreed to when she clicked the box during Blockbuster's online registration process. This distinguishes *Harris* from the decision of the Ninth Circuit Court of Appeals in *Douglas v. Talk America,* 495 F.3d 1062 (9th Cir. 2007), which found *changes* to online terms of use to be unconscionable and, therefore, unenforceable where the user did not assent to or receive proper notice of the change. Specifically, Talk America attempted to enforce an arbitration provision against a customer who had signed up for Talk America's phone service under a service contract that did not include an arbitration provision. Talk America subsequently posted a revised contract online with increased charges and an arbitration provision, but never specifically notified Douglas that the contract had been changed. Douglas eventually found out about the increased charges and filed a class action lawsuit charging Talk America with violation of the Federal Communications Act, breach of contract, and various California consumer protection statutes. Talk America moved to compel arbitration pursuant to the modified contract and the district court granted the motion.

On Douglas's petition for a writ of mandamus, the Ninth Circuit vacated the district court's order compelling arbitration, holding that Talk America's revised contract containing the arbitration clause was not binding on Douglas because Douglas had never agreed to it. Talk America argued that the revised terms were available for Douglas's review on the Talk America website, but the court rejected this argument. According to the court:

> 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. Indeed, a party can't unilaterally change the terms of a contract; it must obtain the other party's consent before doing so. This is because a revised contract is merely an offer and does not bind the parties until it is accepted. And generally "an offeree cannot actually assent to an offer unless he knows of its existence." 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, 495 F.3d at 1066 (citations omitted).

Talk America presents no insurmountable obstacles for website operators and other businesses that rely on standard customer terms, as long as customers are given notice of changes and an opportunity to accept or reject them. *Harris* presents a thornier issue because it calls into question the validity of customer terms containing unilateral modification clauses, even provisions that the customer had notice

of and accepted, regardless of whether the unilateral modification clause is ever actually invoked.

In practical terms, *Harris* is a single district court case and thus not binding precedent for any other court. Moreover, given that unilateral modification provisions in online terms of use are widely used, *Harris* would seem to call into question a common and generally accepted business practice. Indeed, *Harris* is potentially inconsistent with the many prior cases that have held that similar online terms of use are enforceable. *See, e.g.*,*Register.com, Inc. v. Verio, Inc.*, 356 F.3d 393 (2d Cir. 2004). It may be tempting, therefore, to view *Harris* as an outlier that is unlikely to be followed in other cases.

On the other hand, even leaving aside the Fifth Circuit's decision in *Morrison*, *Harris* is consistent with a number of prior cases considering similar issues in the context of arbitration clauses in employee agreements. For example, in 2002, the Tenth Circuit heard an appeal from a decision of the District Court for the District of New Mexico, in which the district court rejected an arbitration clause to which the plaintiffs below had agreed, that apparently was in effect when the dispute arose and that the defendant did not seek to apply retroactively. Nevertheless, because the employee agreement of which the arbitration clause was a part permitted the clause to be withdrawn at any time, the Tenth Circuit agreed with the district court's finding that the arbitration clause was illusory. *Dumais v. American Golf Corp.*, 299 F.3d 1216 (10th Cir. 2002). Similarly, in 2000, the Sixth Circuit applied Kentucky law to make a similar finding concerning disputes that had arisen after the employee/plaintiffs had agreed to arbitration. Again, the finding that the employer's agreement to arbitrate was illusory was based upon the employer's reservation of a right to alter the agreement at will. *Floss v. Ryan's Family Steak Houses*, 211 F.3d 306 (6th Cir. 2000).

Of course, *Dumais* and *Floss* involved employment agreements, not online terms of use. It may be that considerations unique to the employment context influenced the results in *Dumais* and *Floss*, and that these cases should not, therefore, be seen as supporting the *Harris* analysis. It is difficult to predict whether other courts will apply the *Harris* analysis in the context of online terms of use, but the possibility certainly exists. Accordingly, businesses whose terms of use include arbitration provisions with a unilateral right to modify may wish to consider revising their terms of use to make clear that any unilateral modifications will apply only prospectively and after the affected customers have received adequate notice of the changes.
