IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 09-10420

CATHRYN ELAINE HARRIS, on behalf of herself and all others similarly situated; MARIO HERRERA, on behalf of himself and all others similarly situated; AND MARYAM HOSSEINY, on behalf of herself and all others similarly situated,

Plaintiffs-Appellees

v.

BLOCKBUSTER INC.,

Defendant-Appellant

On Appeal from the United States District Court
for the Northern District of Texas, Dallas Division
No. 3:09-cv-217-M, Hon. Barbara M.G. Lynn, Judge Presiding

BRIEF OF APPELLANT

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CERTIFICATE OF INTERESTED PERSONS

Pursuant to 5th Cir. R. 28.2, the cause number and style number are as follows: *Cathryn Harris, on behalf of herself and all others similarly situated; Mario Herrera, on behalf of himself and all others similarly situated; and Maryam Hosseiny, on behalf of herself and all others similarly situated v. Blockbuster Inc.*, No. 09-10420 in the United States Court of Appeals for the Fifth Circuit. The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the Judges of this Court may evaluate possible disqualification or recusal.

- Appellant Blockbuster Inc. is a Delaware corporation headquartered in Dallas, Texas. Blockbuster Inc. does not have a parent corporation, and no publicly-held corporation owns 10% or more of its own stock.
- The following attorneys have appeared on behalf of Appellant either before this Court or in the district court:

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- Appellees Cathryn Harris, Mario Herrera, and Maryam Hosseiny are individuals residing in Dallas, Texas.

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REQUEST FOR ORAL ARGUMENT

Appellant requests oral argument and submits that oral argument will assist the Court. This case presents substantial legal questions of nationwide importance involving the enforceability of arbitration agreements made online. Plaintiffs, members and registered users of Blockbuster Online, claim that Blockbuster violated the Video Protection Privacy Act by disclosing Plaintiffs' movie selections through the social networking site, Facebook.com. Despite Plaintiffs' clickwrap agreement to Blockbuster's Terms and Conditions of Use, including the provision requiring arbitration of their individual claims, Plaintiffs opposed Blockbuster's Motion to Compel Individual Arbitration. In erroneously denying Blockbuster's Motion, the district court exceeded its authority by deciding questions that are properly for the arbitrator, misinterpreted Texas contract law and this Court's opinion in *Morrison v. Amway Corp.*, 517 F.3d 248 (5th Cir. 2008), and gave insufficient weight to the federal public policy favoring arbitration. The extent to which businesses can make and enforce online agreements, including arbitration agreements, while preserving their ability to modify the terms and conditions associated with the use of their products and services is of keen interest to companies across the country. Oral argument will help the Court in addressing and in resolving the significant legal and practical issues presented here.

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JURISDICTIONAL STATEMENT

Plaintiffs Cathryn Elaine Harris, Mario Herrera, and Maryam Hosseiny (collectively, "Plaintiffs") alleged jurisdiction under 18 U.S.C. § 2710(c) and 28 U.S.C. § 1337, because this action arises under the Video Privacy Protection Act, 18 U.S.C. § 2710 (the "VPPA"), a federal statute.

This appeal is brought pursuant to 9 U.S.C. § 16(a)(1), which authorizes immediate appellate review of an order denying a motion to compel arbitration. The district court entered its Order denying Defendant's Motion to Compel Individual Arbitration (the "Order") on March 31, 2009, RE3 at CR235, and its Memorandum Opinion (the "Memorandum Opinion") setting forth the basis for that Order on April 15, 2009. RE4 at CR236-41. Defendant timely filed its Notice of Appeal on April 22, 2009. RE2 at CR242-43.

ISSUES PRESENTED

1. Whether the district court erred in considering Plaintiffs' claim that the change-in-terms provision rendered Blockbuster's Terms and Conditions of Use (the "Terms and Conditions"), including the individual arbitration agreement (the "Arbitration Clause") contained therein, illusory, because, under settled law, challenges to the contract as a whole, such as this one, must be heard in the first instance by the arbitrator.

2. Whether the district court erred in holding that the change-in-terms provision rendered the Arbitration Clause illusory, despite the fact that:

a. The Arbitration Clause is contained within a broader contract that provides the necessary consideration for the Arbitration Clause;

b. Even if the Arbitration Clause were illusory, it became enforceable when Blockbuster rendered part performance in exchange for the promises at issue;

c. Even if the Arbitration Clause were a stand-alone agreement, the challenged provisions would not render it illusory.

3. Whether Plaintiffs' other attacks on the Arbitration Clause, which the district court did not address, lack merit, including:

a. Plaintiffs' contention that they did not agree to be bound by the Terms and Conditions;

b. Plaintiffs' contention that the Arbitration Clause is unconscionable.

STATEMENT OF THE CASE

A. Course of Proceedings/Disposition Below.

The claims at issue in this putative class-action case arise from Plaintiffs' use of Blockbuster's website and their participation in Blockbuster's online DVD subscription service, Blockbuster Online. Specifically, Plaintiffs challenge a

program that allowed Blockbuster Online customers to share information with their friends through the social networking site, Facebook.com. Plaintiffs allege that this program violates the VPPA. Plaintiffs' claims, however, are covered by an individual arbitration agreement that Plaintiffs accepted—as part of Blockbuster's general Terms and Conditions—when they became registered users of Blockbuster's website and members of Blockbuster Online. **It is undisputed that Blockbuster has not amended or changed the relevant online Terms and Conditions, including the Arbitration Clause, since Plaintiffs became members of Blockbuster Online.** RE5 at CR70.

Plaintiffs filed this putative class-action lawsuit against Blockbuster on April 9, 2008 in the Marshall Division of the Eastern District of Texas. CR5-18. Blockbuster quickly moved to compel arbitration, filing its Motion to Compel Individual Arbitration (the "Motion") on July 30, 2008. CR53-66. Following the transfer of this action to the Northern District of Texas pursuant to Blockbuster's Motion to Transfer Venue, the district court denied Blockbuster's Motion to Compel Individual Arbitration. The district court issued an Order denying the Motion on March 31, 2009, RE3 at CR235, and a Memorandum Opinion setting forth the basis for that Order on April 15, 2009. RE4 at CR236-41. Blockbuster appeals the district court's Order denying enforcement of the Arbitration Clause.

In its Memorandum Opinion, the district court, relying on this Court's opinion in *Morrison v. Amway Corp.*, 517 F.3d 248 (5th Cir. 2008), held that the Arbitration Clause contained in Blockbuster's Terms and Conditions is illusory and unenforceable "for the same reasons as that in *Morrison*." RE4 at CR239. Specifically, the district court held that the Arbitration Clause was illusory because Blockbuster, in its Terms and Conditions, reserved the right to change those Terms and Conditions "at its sole discretion" and "at any time," and provided that such modifications will be effective upon posting to the Blockbuster website. RE4 at CR239.

The district court briefly addressed two differences it perceived between Blockbuster's Terms and Conditions and the arbitration agreement at issue in *Morrison*. First, the court noted that "[t]he *Morrison* contract was a stand-alone agreement, and as such required independent consideration." RE4 at CR240. The district court recognized the settled principle of Texas law that "where, as here, an arbitration clause is incorporated into a larger contract, the benefits of the underlying contract can serve as consideration." RE4 at CR240. Second, the court noted that "in *Morrison*, the defendant was actually attempting to retroactively apply the arbitration agreement to events that had happened before it was in effect, and there is no suggestion [of that] here." RE4 at CR240. As discussed below, the district court erred in even reaching the issue of whether the Terms and Conditions

are illusory and in declining to enforce the Arbitration Clause in light of these key distinctions from *Morrison*.

Because the district court held that the Arbitration Clause is illusory, it did not reach Plaintiffs' other challenges to the enforcement of the Arbitration Clause. Blockbuster timely filed its Notice of Appeal on April 22, 2009. RE2 at CR242-43. The district court has stayed proceedings pending appeal. *See* CR273.

B. Statement of Facts.

According to the First Amended Complaint ("FAC"), Plaintiffs are registered users of Blockbuster's website and members of Blockbuster Online. *See* RE6 at CR20-21. Blockbuster Online is a DVD rental subscription program in which members pay a flat monthly rate to receive DVDs through the mail. *See* RE5 at CR67-68. To select the DVDs they wish to receive, Blockbuster Online members use Blockbuster's website to create and manage their own "movie queues," removing or adding movies as they choose. RE5 at CR68.

In exchange for the right to use the website and to rent DVDs through Blockbuster Online, Blockbuster requires Blockbuster Online members to agree to abide by Blockbuster's Terms and Conditions. All Blockbuster Online members sign up for the program through Blockbuster's website, www.blockbuster.com. RE5 at CR68. Early in the sign-up process, prospective members are asked to provide basic information (*e.g.*, name, email address, selected password) that

enables Blockbuster to open an account for them. RE5 at CR68. Before they submit this information, all prospective members must "click" on a box that appears next to the following statement:

> I have read and agree to the blockbuster.com (including Blockbuster Online Rental) **Terms and Conditions** and certify that I am at least 13 years of age.

RE 5 at CR68.

By following the **Terms and Conditions** hyperlink,[1] prospective members are taken to a page containing the full Terms and Conditions governing membership in Blockbuster Online and use of the Blockbuster website. CR68-69. These Terms and Conditions include, among other things, the Arbitration Clause—an individual arbitration agreement which provides the sole method for resolving disputes relating to the use of Blockbuster's website and Blockbuster Online:

> **DISPUTE RESOLUTION**
>
> All claims, disputes or controversies (whether in contract or tort, pursuant to statute or regulation, or otherwise, and whether pre-existing, present or future) arising out of or relating to: (a) these Terms and Conditions of Use; (b) this Site; (c) any advertisement or promotion relating to these Terms and Conditions of Use or this Site; or (d) transactions effectuated through this Site, or (e) the relationship which results from these Terms and Conditions of Use (including relationships with third

[1] A "hyperlink" is "an electronic link providing direct access from one distinctively marked place . . . to another in the same or a different document." *See* MERRIAM-WEBSTER ONLINE DICTIONARY (2009), *available at* www.merriam-webster.com/dictionary/hyperlink. The hyperlink to the Blockbuster website Terms and Conditions is underlined and in blue type, obviously identifiable as a hyperlink to any computer user.

> parties who are not party to these Terms and Conditions of Use) (collectively "Claims"), will be referred to and determined by binding arbitration governed by the Federal Arbitration Act and administered by the American Arbitration Association under its rules for the resolution of consumer-related disputes, or under other mutually agreed procedures. Because this method of dispute resolution is personal, individual and provides the exclusive method for resolving such disputes, you further agree, to the extent permitted by applicable laws, to waive any right you may have to commence or participate in any class action or class-wide arbitration against Blockbuster related to any Claim.
>
> This provision shall survive the termination of your right to use this Site.

See RE5 at CR68, CR75-76.[2] If prospective members do not click the box, they are not allowed to continue with the sign-up process; instead, they are shown the same screen again, this time with the message, "*Please review and accept the terms and conditions*" appearing in red type at the top of the screen. RE5 at CR69-70.

Blockbuster's Terms and Conditions also contain the following three provisions that Plaintiffs challenged in connection with Blockbuster's motion to enforce the Arbitration Clause:

> **CHANGES TO TERMS AND CONDITIONS**
>
> Blockbuster may at any time, and at its sole discretion, modify these Terms and Conditions of Use, including

[2] Blockbuster has not modified the relevant online Terms and Conditions, including the Arbitration Clause, since Plaintiffs became members of Blockbuster Online. *See* RE5 at CR70.

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.

***

TERMINATION

Blockbuster may at any time and at its sole discretion terminate your right to use this Site.

***

LIMITATION OF LIABILITY

IN NO EVENT SHALL BLOCKBUSTER, ITS AFFILIATES, BLOCKBUSTER FRANCHISEES AND ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR OTHER REPRESENTATIVES BE LIABLE FOR ANY DIRECT, INDIRECT, SPECIAL, INCIDENTAL, CONSEQUENTIAL, PUNITIVE OR AGGRAVATED DAMAGES (INCLUDING WITHOUT LIMITATION DAMAGES FOR LOSS OF DATA, INCOME OR PROFIT, LOSS OF OR DAMAGE TO PROPERTY AND THIRD PARTY CLAIMS) OR ANY OTHER DAMAGES OF ANY KIND, ARISING OUT OF OR IN CONNECTION WITH: THIS SITE; ANY MATERIALS, INFORMATION, QUALIFICATION AND RECOMMENDATIONS APPEARING ON THIS SITE; ANY SOFTWARE, TOOLS, TIPS, PRODUCTS, OR SERVICES OFFERED THROUGH, CONTAINED IN OR ADVERTISED ON THIS SITE; ANY LINK PROVIDED ON THIS SITE; AND YOUR ACCOUNT AND PASSWORD, WHETHER OR NOT

> BLOCKBUSTER HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. THIS EXCLUSION OF LIABILITY SHALL APPLY TO THE FULLEST EXTENT PERMITTED BY LAW. THIS PROVISION SHALL SURVIVE THE TERMINATION OF YOUR RIGHT TO USE THIS SITE.
>
> YOU ACKNOWLEDGE THAT YOU WILL BE FULLY LIABLE FOR ALL DAMAGES RESULTING DIRECTLY OR INDIRECTLY FROM YOUR USE OF THIS SITE.

RE 5 at CR75. These provisions are part of the same underlying contract, but are separate and distinct from the Arbitration Clause.

Once prospective members click the Terms and Conditions box and complete the sign-up process, they receive a confirmation email from Blockbuster. That email contains another hyperlink to the Terms and Conditions—the same ones they read and accepted during the sign-up process. RE5 at CR70. In addition, the Terms and Conditions are always accessible by hyperlink at the bottom of the Blockbuster website. RE5 at CR70.

SUMMARY OF THE ARGUMENT

The district court erred in holding the Arbitration Clause illusory—and indeed, in addressing that argument at all. Plaintiffs' argument—which is based entirely on provisions outside the Arbitration Clause—is an attack on the contract as a whole, rather than a specific attack on the Arbitration Clause. As such, this argument must be heard by the arbitrator in the first instance. *See Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445, 449 (2006). The district court

should have determined only whether an agreement exists—by virtue of Plaintiffs having "clicked" on a box indicating that they had reviewed and agreed to Blockbuster's Terms and Conditions—and, if so, whether that agreement withstands Plaintiffs' unconscionability attack.

Neither of these issues is difficult, as well-established precedent makes clear that Plaintiffs' contract formation and unconscionability challenges are meritless. The evidence clearly demonstrates that Plaintiffs agreed to accept Blockbuster's Terms and Conditions, including the Arbitration Clause, and the district court did not find otherwise. The type of agreement at issue here, often referred to as a "clickwrap" agreement, is regularly enforced by Texas courts. Moreover, the applicable Texas and federal case law makes clear that Plaintiffs' unconscionability attacks are without merit. The Arbitration Clause (and the Terms and Conditions) are neither substantively nor procedurally unconscionable.

However, even if a federal court could properly consider Plaintiffs' attacks on the contract as a whole, neither the Terms and Conditions, nor the Arbitration Clause, are illusory. First, the Arbitration Clause is distinguishable from those that this and other courts have found illusory because it is not a stand-alone agreement, but rather is contained within a larger contract. Second, even if the Terms and Conditions ***were*** illusory, they became enforceable when Blockbuster performed under the Terms and Conditions. Texas contract law provides that Plaintiffs—

having used the Blockbuster Online services and having accepted the benefits of the Blockbuster Terms and Conditions—cannot claim that their agreement to arbitrate was without consideration. Finally, even if the Arbitration Clause were a stand-alone agreement, the challenged provisions would not render it illusory because, among other things, nothing in the Terms and Conditions permits Blockbuster to retroactively amend or terminate the Arbitration Clause. Indeed, it is undisputed that Blockbuster has not modified the relevant online Terms and Conditions, including the Arbitration Clause, since Plaintiffs became members of Blockbuster Online. *See* RE5 at CR70.

The district court simply held that the challenge to the Arbitration Clause was properly before the court and, without analysis, extended *Morrison* and held that the Arbitration Clause was illusory. *See* RE4 at CR240. The court failed to address fully Blockbuster's argument that the Arbitration Clause is not illusory because it is incorporated into a larger contract, the benefits of which and the performance of which serve as consideration. Although independent consideration is necessary for stand-alone arbitration agreements, integrated arbitration clauses—such as the one at issue here—do not require independent consideration, as the consideration provided by the rest of the contract is sufficient to support the Arbitration Clause. Moreover, even if the Arbitration Clause were illusory, it

became enforceable under Texas contract law when Blockbuster performed services in exchange for the promises at issue here.

Second, the court, relying solely on one unpublished district court opinion, summarily rejected the second distinction between this case and *Morrison*. Adopting the limited analysis set forth in *Simmons v. Quixtar, Inc.*, No. 4:07cv389, 2008 WL 2714099, at *2 (E.D. Tex. July 9, 2008) (not designated for publication), the court held that "the rule in *Morrison* applies even to cases where there was no attempt to apply a contract modification to prior events." RE4 at CR240. There is no suggestion in this case that Blockbuster is trying to impose the Arbitration Clause on Plaintiffs retroactively. The Arbitration Clause has been a part of the Terms and Conditions since Plaintiffs accepted those Terms and Conditions and became members of Blockbuster Online. Contrary to the district court's suggestion, this Court's holding in *Morrison* should not be extended here. The Arbitration Clause is valid and should be enforced.

ARGUMENT

I. STANDARDS APPLICABLE TO THE COURT OF APPEALS' REVIEW OF THE DENIAL OF BLOCKBUSTER'S MOTION TO COMPEL INDIVIDUAL ARBITRATION

This Court reviews the denial of Defendant's Motion to Compel Individual Arbitration *de novo*, applying the same standards as the district court. *JP Morgan Chase & Co. v. Conegie*, 492 F.3d 596, 598 (5th Cir. 2007).

There is a two-step inquiry to determine whether a party should be compelled to arbitrate. *Washington Mut. Fin. Group v. Bailey*, 364 F.3d 260, 263 (5th Cir. 2004). This Court must first ascertain whether the parties agreed to arbitrate the dispute. *Id.* In making this determination, there are two considerations: "(1) whether there is a valid agreement to arbitrate between the parties; and (2) whether the dispute in question falls within the scope of that arbitration agreement." *Will-Drill Res., Inc. v. Samson Res. Co.*, 352 F.3d 211, 214 (5th Cir. 2003).[3] If the Court determines that the parties agreed to arbitrate, then it must further determine "whether any federal statute or policy renders the claims nonarbitrable." *Bailey*, 364 F.3d at 263.

By its terms, the Arbitration Clause is governed by the Federal Arbitration Act (the "FAA" or the "Act"), 9 U.S.C. § 1 *et seq*. It is well established that the FAA embodies a "liberal federal policy favoring arbitration." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25 (1991). The FAA creates a presumption in favor of arbitrability and courts must resolve all doubts in favor of arbitration. *Id.* at 26; *see also Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 297 (5th Cir. 2004) (recognizing the "strong presumption in favor of arbitration" and holding that "individuals seeking to avoid the enforcement of an

[3] Generally, principles of state contract law govern the question of whether the parties formed a valid agreement to arbitrate. *Bailey*, 364 F.3d at 264. The Blockbuster Terms and Conditions are governed by Texas law, and the parties agree that Texas law controls. *See* CR102-17 (applying Texas law to the arbitration analysis).

arbitration agreement face a high bar . . . even where, as here, the claims subject to arbitration are statutory in nature"). To further the FAA's strong pro-arbitration policy, the Act limits the grounds upon which a court may refuse to enforce an arbitration agreement. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270 (1995) ("[T]he basic purpose of the [FAA] is to overcome courts' refusals to enforce agreements to arbitrate.").

Section 2 of the FAA requires that any defense to arbitration must be applicable to contracts generally. *See* 9 U.S.C. § 2. In other words, the FAA preempts any rule or decision of state law that would subject arbitration agreements to more burdensome contract formation requirements than those required for any other type of contract. *See Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985); *see also Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 89 (2000) (noting that the purpose of the FAA is "to reverse the longstanding judicial hostility to arbitration agreements . . . and to place [them] upon the same footing as other contracts") (internal quotation marks and citations omitted). Plaintiffs' various attacks on the Arbitration Clause should be considered in light of this strong policy in favor of arbitration.

II. THE DISTRICT COURT ERRED IN HOLDING THAT BLOCKBUSTER'S CHANGE-IN-TERMS PROVISION RENDERED THE ARBITRATION AGREEMENT ILLUSORY

It is undisputed that Plaintiffs' claims fall under the scope of the Arbitration Clause at issue in this case. The only issue on appeal is whether the Arbitration Clause is enforceable. As set forth above, the court erred in considering Plaintiffs' argument that the Terms and Conditions are illusory and in holding that there is no valid or enforceable agreement to arbitrate this dispute.

A. Plaintiffs' Claim That The Terms and Conditions Are Illusory Is A Challenge To The Contract As A Whole and Should Be Heard By The Arbitrator.

The court erred in addressing Plaintiffs' claim that the change-in-terms provision renders the entire Terms and Conditions illusory, as "a challenge to the validity of a contract as a whole, and not specifically to the arbitration clause within it, must go to the arbitrator, not the court."[4] *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449 (2006); *see also Pleasant v. Houston Works USA*, 236 Fed. App'x 89, 92 (5th Cir. 2007) (holding that "challenges to the enforceability of a contract containing an arbitration clause are determined by the arbitrator"); *Will-Drill Res.*, 352 F.3d at 218 ("[W]here parties have formed an agreement which contains an arbitration clause, any attempt to dissolve that

[4] The district court—ignoring the clear language in *Buckeye Check Cashing* and many other federal and Texas state cases—summarily rejected Blockbuster's argument that this claim is one that must be heard by the arbitrator. *See* RE4 at CR240.

agreement by having the entire agreement declared void or voidable is for the arbitrator. Only if the arbitration clause is attacked on an independent basis can the court decide the dispute; otherwise, general attacks on the agreement are for the arbitrator."). The Supreme Court has explained that "[c]hallenges to the validity of arbitration agreements . . . can be divided into two types": (1) challenges specifically to the "validity of the agreement to arbitrate," and (2) challenges to "the contract as a whole, either on a ground that directly affects the entire agreement, or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid." *Buckeye Check Cashing*, 546 U.S. at 444. Although challenges to the validity of the arbitration agreement may be heard by a court, challenges to the validity of the contract as a whole must go to the arbitrator. *Id.* at 449.[5] Stated otherwise, the Supreme Court has instructed lower courts "to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue.'" *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967) (quoting 9 U.S.C. § 4).

[5] This doctrine is based on the principle that "'arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are embedded.'" *ITT Educ. Servs. Inc. v. Arce*, 533 F.3d 342, 344-47 (5th Cir. 2008) (quoting *Prima Paint*, 388 U.S. at 402) (holding that "even if the arbitrator made a finding of fraudulent inducement as to the entire contract, the arbitration clause . . . is 'separable' and remains valid and enforceable).

The district court considered whether the entire Terms and Conditions (including its Arbitration Clause) were rendered illusory by the change-in-terms provision. This issue should have gone to the arbitrator. *Buckeye*, 546 U.S. at 449 (holding that the claim at issue was of the "second type"—and must go to the arbitrator—where "[t]he crux of the complaint [was] that the contract as a whole (including its arbitration provision) [was] rendered invalid by [an] usurious finance charge"); *see also Sosa v. PARCO Oilfield Servs., Ltd.*, No 2:05-CV-153, 2006 WL 2821882, at *4 (E.D. Tex. Sept. 27, 2006) (not designated for publication) (interpreting Texas law as providing that a challenge to an arbitration clause contained within a larger contract must go to the arbitrator); *In re Merrill Lynch Trust Co.*, 235 S.W.3d 185, 190 (Tex. 2007) (holding that challenges to arbitration agreement based on general change-in-terms and termination provisions were for the arbitrator).

Plaintiffs cannot avoid the operation of this rule simply by styling their attack as one on the Arbitration Clause in particular, rather than on the contract as a whole. Their arguments about the illusory nature of the Terms and Conditions focus solely on provisions other than the Arbitration Clause—*i.e.*, the change-in-terms provision, the termination provision, and the limitation-of-liability provision. If Plaintiffs' claims render any provision illusory (which they do not), they render the entire Terms and Conditions illusory. Where, as here, the clauses at issue "are

contained throughout the contract and are not particular to the arbitration provision," a claim based on those clauses "pertains to the contract[] as a whole and is, thus, subject to arbitration." *Universal Computer Consulting Holding, Inc. v. Hillcrest Ford Lincoln-Mercury*, Nos. 14-04-00819-CV, 14-04-01103-CV, 2005 WL 2149508, at *5 (Tex. App.—Houston [14th Dist.] 2005, no pet.) (not designated for publication). Therefore, Plaintiffs' claim is an attack on the contract as a whole and must be considered in the first instance by the arbitrator.

B. The Arbitration Clause Is Not Illusory And Should Be Enforced.

Even if the district court could consider Plaintiffs' claims that the Terms and Conditions (including the Arbitration Clause) were illusory, it erred in holding that the general change-in-terms provision in Blockbuster's Terms and Conditions renders the Arbitration Clause illusory and unenforceable. The district court relied on this Court's decision in *Morrison v. Amway Corp.*, 517 F.3d 248 (5th Cir. 2008), for its holding that the Arbitration Clause is illusory. The district court, however, overlooked important differences between the facts in this case and those at issue in *Morrison* that compel a different result here.

1. The Arbitration Clause is not illusory because it is contained within a broader contract that provides the necessary consideration for the Arbitration Clause.

As the district court recognized, *Morrison*—like almost every other case in which an arbitration agreement has been found to be illusory—involved a stand-

alone arbitration agreement that required independent consideration to be enforceable. *See* RE4 at CR240 (finding *Morrison* distinguishable on the ground that "[t]he *Morrison* contract was a stand-alone agreement, and as such required independent consideration"). In contrast, the Arbitration Clause here is contained within a broader contract—Blockbuster's Terms and Conditions—which provides the necessary consideration for the Arbitration Clause. The question of whether a stand-alone arbitration agreement is illusory is distinct from and must be analyzed differently than the question of whether an arbitration provision contained within a broader contract is illusory. The district court's opinion, insofar as it fails to consider fully the important distinction between these two types of agreements, is fundamentally flawed.

Texas courts distinguish "integrated" arbitration clauses from stand-alone arbitration agreements on the basis of the consideration offered for each. *See, e.g.*, *In re AdvancePCS Health L.P.*, 172 S.W.3d 603, 607 (Tex. 2005) (per curiam). In stand-alone arbitration agreements, binding promises are required on both sides because the only consideration for the agreement is the mutual promises to arbitrate. *See id.* ("In the context of stand-alone arbitration agreements, binding promises are required on both sides as they are the only consideration rendered to create a contract."); *In re Champion Techs., Inc.*, 222 S.W.3d 127, 130 (Tex. App.—Eastland 2006, pet. denied) (same). Accordingly, when a party retains the

unilateral right to modify or terminate that agreement, its promise to arbitrate becomes illusory and the arbitration agreement fails for lack of consideration. *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 231 n.2 (Tex. 2003).

In contrast, when an arbitration agreement is contained within a broader contract, it need not be supported by independent consideration in the form of mutual promises to arbitrate: the consideration provided by the rest of the contract serves as the consideration for the arbitration clause. *AdvancePCS*, 172 S.W.3d at 607; *see also Coleman v. Qwest Commc'ns Corp.*, No. Civ.A. 3:02CV2428-P, 2003 WL 22388482, at *3 n.1 (N.D. Tex. Sept. 30, 2003) (not designated for publication) (finding that an arbitration clause contained within a broader compensation plan agreement was not illusory—despite the fact that the defendant reserved the right to modify, suspend, or terminate the plan at any time, with or without notice—because it "is part of a larger agreement that is supported by adequate consideration," distinguishing *Davidson* on the ground that *Davidson* "involved a stand-alone arbitration agreement"); *In re Palm Harbor Homes*, 195 S.W.3d 672, 676 (Tex. 2006) (noting that "when an arbitration clause is part of a larger, underlying contract, the remainder of the contract may suffice as consideration for the arbitration clause" and finding that the underlying contract in that case "constituted valid consideration for the arbitration agreement"); *Neatherlin Homes, Inc. v. Love*, Nos. 13-06-328-CV, 13-06-411-CV, 2007 WL

700996, at *6 (Tex. App.—Corpus Christi 2007, no pet.) (not designated for publication) (finding that the underlying contract between the parties constituted valid consideration for the arbitration agreement as between them); *Sosa*, 2006 WL 2821882 at *4 (distinguishing *Davidson* on the ground that the modification and termination provision at issue there was contained within a stand-alone arbitration agreement).

The Texas Supreme Court has made clear that these are two distinct inquiries, holding that an arbitration agreement was not illusory because the rest of the underlying contract—including the defendant's part performance under that contract—provided the necessary consideration, and ***separately*** evaluating whether the arbitration agreement would be illusory if it were a stand-alone agreement. *See AdvancePCS*, 172 S.W.3d at 607-08. This key distinction explains why courts rarely find arbitration clauses illusory when they are part of a larger agreement. *See, e.g.*, *Sosa*, 2006 WL 2821882 at *4 (finding that an arbitration clause was not illusory, despite the fact that it could be terminated at any time, because the rest of the agreement provided the necessary consideration: "the parties' agreement regarding compensation for occupational injuries serves as sufficient consideration because the arbitration clause was part of an underlying contract"); *Palm Harbor Homes*, 195 S.W.3d at 676 (finding that "[t]he underlying contract . . . constituted valid consideration for the arbitration agreement"); *Neatherlin Homes*, 2007 WL

700996 at *6 (finding that the underlying contract between the parties constituted valid consideration for the arbitration agreement as between them). Indeed, in a recent case, a Texas Court of Appeals held that an arbitration provision was not illusory—despite the fact that the defendants could terminate the agreement "upon notice" and change the terms of the agreement "with or without notice"—because the underlying agreement provided the consideration necessary for the arbitration provision. *Frequent Flyer Depot, Inc. v. Am. Airlines, Inc.*, 281 S.W.3d 215, 225 (Tex. App.—Fort Worth 2009, pet. filed).[6]

Of course, much like *AdvancePCS*, Blockbuster provides substantial consideration to Plaintiffs in the underlying contract, including, for example, the right to use the Blockbuster Online website (RE5 at CR76), access to Blockbuster's video library (RE5 at CR76-78), use of Blockbuster's movie rental queue (RE5 at CR76-78), direct delivery of DVDs to members' homes (RE5 at CR77), prepaid postage each way (RE5 at CR77), the ability to return online

[6] Courts in other jurisdictions similarly recognize that stand-alone arbitration agreements are analyzed differently than those contained within a broader contract. *Compare High v. Capital Senior Living Properties 2-Heatherwood, Inc.*, 594 F. Supp. 2d 789 (E.D. Mich. 2008), *with Floss v. Ryan's Family Steak Houses, Inc.*, 211 F.3d 306, 316 (6th Cir. 2000); *see, e.g., Barker v. Golf U.S.A., Inc.*, 154 F.3d 788, 792 (8th Cir. 1998) (applying Oklahoma law and concluding that "mutuality of obligation is not required for arbitration clauses so long as the contract as a whole is supported by consideration"); *Doctor's Assocs., Inc. v. Distajo*, 66 F.3d 438, 453 (2d Cir. 1995) (applying Connecticut law and finding that when an arbitration agreement is integrated into a larger contract, consideration for the contract as a whole would cover the arbitration clause as well); *Wilson Elec. Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167, 169 (6th Cir. 1989) (finding that an arbitration clause contained within a larger contract did not require consideration independent from the consideration for the underlying contract).

rentals to Blockbuster stores (RE5 at CR78-79), e-coupons (RE5 at CR79-80), use of Blockbuster's Friends and Family Service (RE5 at CR87-88), and a license to use the copyrighted materials on the site (RE5 at CR74-75). The consideration underlying Blockbuster's Terms and Conditions provides the necessary consideration for the Arbitration Clause contained therein, even if that clause, by itself, would have been illusory. The district court's decision, insofar as it failed to analyze correctly the key distinction between stand-alone and integrated arbitration agreements, is fundamentally flawed and should be reversed.

2. Even if the Arbitration Clause were illusory, it became enforceable when Blockbuster rendered part performance in exchange for the promises at issue.

Even if the Terms and Conditions did not supply the necessary consideration for the Arbitration Clause, this clause is still enforceable because a promise—even if illusory—can serve as the basis for a valid contract if accepted by performance. *See AdvancePCS*, 172 S.W.3d at 607 (enforcing an arbitration clause contained within a larger contract despite the fact that the contract could be modified or amended at will, noting that "[h]aving used [the defendant's] services and network to obtain reimbursements for 10 years, the [plaintiffs] cannot claim their agreement to arbitrate was without consideration"). In this case, Blockbuster has already performed under its Terms and Conditions by conferring benefits on Plaintiffs in the form of movie rentals and other services associated with the Blockbuster

Online program. Plaintiffs are registered users of Blockbuster Online and allege that they have used the Blockbuster website to rent and purchase movies and to add movies to their online queues. *See* RE6 at CR20-21, 28-29. Blockbuster spent time, money and resources to build its website and provide goods and services to customers, such as Plaintiffs, through the website. These benefits constitute sufficient consideration to render the entire agreement, including the Arbitration Clause, valid and enforceable, even if, as Plaintiffs claim, Blockbuster's promise to arbitrate was illusory.

The Texas Supreme Court has recognized, as a basic principle of contract law, that even if one promise is illusory, an enforceable contract can still be formed—"the non-illusory promise can serve as an offer, which the promisor who made the illusory promise can accept by performance." *Alex Sheshunoff Mgm't Servs., L.P. v. Johnson*, 209 S.W.3d 644, 650 (Tex. 2006). In *Johnson*, the Texas Supreme Court held that an at-will employee's covenant not to compete became enforceable when the employer performed promises it made in exchange for that covenant. *Id.* The court held: "if, as in the pending case, the employer's consideration is provided by performance and becomes non-illusory at that point, and the agreement in issue is otherwise enforceable . . . , we see no reason to hold that the covenant fails." *Id.* at 651.

Similarly, in *Cherokee Communications, Inc. v. Skinny's, Inc.*, 893 S.W.2d 313, 316 (Tex. App.—Eastland 1995, writ denied), the court found that the defendant's right to terminate an arbitration agreement did not render the agreement illusory and unenforceable because the defendant had performed under the underlying agreements by installing telephones and making lease payments. Relying in part on the applicable equitable principles, the court held that the defendant's part performance under the agreement conferred a benefit on the plaintiff and such benefit constituted "equitable consideration," which rendered the entire contract valid and enforceable. *Id.*; *see also AdvancePCS*, 172 S.W.3d at 607 (in finding that the arbitration provision was not rendered illusory by the defendant's ability to cancel the agreement at will, the Texas Supreme Court noted: "[h]aving used [the defendants'] services and network to obtain reimbursements for 10 years, the [plaintiffs] cannot claim their agreement to arbitrate was without consideration").

This rule involving performance is not a new one. Rather, the Texas Supreme Court has long recognized the principle that performance under a contract can render that contract enforceable:

> Though a contract be void for lack of mutuality at the time it is made, and while it remains wholly executory, yet, ***when there has been even a part performance*** by the party seeking to enforce the same, ***and in such part performance such party has rendered services or incurred expense*** contemplated by the parties at the time

> such contract was made, ***which confers even a remote benefit on the other party*** thereto, ***such benefit will constitute an equitable consideration, and render the entire contract valid and enforceable.***. . . . The test of mutuality is to be applied, not as of the time when the promises are made, but as of the time when one or the other is sought to be enforced.

Hutchings v. Slemons, 174 S.W.2d 487, 489 (Tex. 1943) (emphasis added) (internal citations omitted); *see also Thomas v. W. Indem. Co.*, 246 S.W. 345, 347 (Tex. Comm'n App. 1922, opinion adopted) (holding that a provision in a contract that gives one party an option to terminate does not destroy mutuality and render the contract void where "the promises in question have . . . been performed in good faith").

In this case, as in the cases discussed above, the contract at issue—even if illusory when made—was rendered valid and enforceable by Blockbuster's performance under the contract. Before this action was filed, Blockbuster had already performed under its Terms and Conditions by conferring benefits on Plaintiffs in the form of movie rentals and other services associated with the Blockbuster Online program. Under Texas law, these benefits constitute sufficient consideration to render the entire agreement, including the arbitration provision, valid and enforceable, even if, as Plaintiffs claim, Blockbuster has the power to amend or terminate the agreement at any time. *See Cherokee Communications*, 893 S.W.2d at 316. Plaintiffs—having used the Blockbuster Online services and

having accepted the benefits of the Blockbuster Terms and Conditions—"cannot claim that their agreement to arbitrate was without consideration." *AdvancePCS*, 172 S.W.3d at 607.[7]

3. Even if the Arbitration Clause were a stand-alone agreement, the change-in-terms provision would not render the agreement illusory.

a. Because there is no retroactive application of an arbitration provision here, *Morrison* does not apply, and the Arbitration Clause should be enforced.

As the district court recognized, the defendant in *Morrison*—unlike Blockbuster—was attempting to retroactively apply an arbitration agreement to events pre-dating the effective date of the arbitration agreement. *See* RE4 at CR240; *Morrison*, 517 F.3d at 256. Although the district court (and at least one other court, *see Simmons v. Quixtar, Inc.*, No. 4:07cv389, 2008 WL 2714099 (E.D. Tex. July 9, 2008) (not designated for publication)), held that *Morrison* applies even where there is no attempt to apply a contract modification to prior events, *Morrison* does not go that far. The fact that the defendant in *Morrison* was seeking to enforce an arbitration agreement with respect to a dispute that arose and matters

[7] Plaintiffs, having accepting the benefits of the Terms and Conditions, are also equitably estopped from arguing that the arbitration provision contained therein is unenforceable. *See Sosa*, 2006 WL 2821882 at *5 (finding that the plaintiff, after accepting benefits under an employment benefit plan, "must accept the terms of the contract, including its arbitration provision" based on principles of equitable estoppel) (citing *Washington Mut. Fin. Group v. Bailey*, 364 F.3d 260 (5th Cir. 2004) (enforcing arbitration agreement against illiterate borrower's wife who was nonsignatory to the agreement based on principles of equitable estoppel)).

that occurred before the arbitration agreement was in effect played a key role in the *Morrison* decision. Indeed, this Court distinguished two recent Texas Supreme Court cases on that basis in *Morrison*, 517 F.3d at 256 & n.10.

Specifically, the *Morrison* court distinguished *In re AdvancePCS Health L.P.*, 172 S.W.3d 603 (Tex. 2005), on the ground that the defendant in *Morrison* sought "to enforce an arbitration agreement *with respect to* a dispute which arose, and concerns matters which occurred, *before* the arbitration provision was first introduced in September 1997." *Morrison*, 517 F.3d at 256 (emphasis in original). The *Morrison* court similarly distinguished *In re Dillard Department Stores, Inc.*, 198 S.W.3d 778 (Tex. 2006), in large part, based on the fact that "the claims in question [in *Morrison*] arose prior to any arbitration provision or notice thereof," and the defendant was attempting to apply that modified agreement to the plaintiffs' claims. *Morrison*, 517 F.3d at 256 n.10.

In this case, it is undisputed that Blockbuster has not modified the relevant online Terms and Conditions, including the Arbitration Clause, since Plaintiffs became registered users and members of Blockbuster Online. *See* RE5 at CR70. The question of whether actual, future changes would apply retroactively will depend on notice issues and the facts and circumstances surrounding any modifications. *See* CR125; *see also* section II(B)(3)(iii), *infra*. These inquiries are

irrelevant where, as here, the Arbitration Clause was in effect when the claims in question arose and has not been modified.

b. The change-in-terms provision does not render the Arbitration Clause illusory because it requires Blockbuster to notify its members of changes to the Terms and Conditions by posting such changes on the Blockbuster website.

Even if a federal court could consider Plaintiffs' challenge to the change-in-terms provision, and even if the rest of the parties' agreement and Blockbuster's performance thereunder did not supply the necessary consideration for the Arbitration Clause, the change-in-terms provision would not render the Arbitration Clause illusory.

(i) Because the change-in-terms provision requires Blockbuster to provide notice of changes, the Arbitration Clause is not illusory.

A change-in-terms provision will not render an arbitration provision illusory when it requires the promisor to provide notice of any changes to the contract. *See Iberia Credit Bureau v. Cingular Wireless L.L.C.*, 379 F.3d 159, 173-74 (5th Cir. 2004) (where the defendant companies were required to give notice of changes, change-in-terms provisions in contracts did not render the contracts illusory); *Dillard Dep't Stores*, 198 S.W.3d at 782 (arbitration agreement was not illusory because changes would not affect employees who did not receive notice of the changes and accept them); *D.R. Horton, Inc. v. Brooks*, 207 S.W.3d 862, 869 (Tex.

App.—Houston [14th Dist.] 2006, no pet.) ("Because any changes or amendments must be communicated through notice, the promise to arbitrate is not illusory."). The change-in-terms provision at issue states that modifications to Blockbuster's Terms and Conditions will be effective only after they are posted on the Blockbuster website. RE5 at CR72. Plaintiffs explicitly agreed "to review the[] Terms and Conditions of Use periodically," and acknowledged that their "continued use of this Site following such modifications will indicate [their] acceptance of these modified Terms and Conditions of Use." *Id.* If Plaintiffs do not agree to any of the modifications, the remedy is simple—Plaintiffs can stop using Blockbuster's online services and thereby not accept said modifications. *Id.*

This change-in-terms provision does not render the Arbitration Clause illusory. In *Iberia Credit Bureau*, 379 F.3d at 173-74, the Fifth Circuit held that a change-in-terms provision did not render an arbitration provision illusory where "[t]he notice of the change in terms can be understood as an invitation to enter into a relationship governed by the new terms," which the customer could choose to accept by continuing to use the service. The court held that "[t]he fact that the company ha[d] the right to change the terms upon notice does not mean that the contract never bound it," and "the fact that the companies could later attempt to change the arbitration clause to render it oppressive [did not] mean that the arbitration clause, as it stands, [was] unconscionable." *Id.* at 174.

Similarly, an arbitration agreement is not illusory where changes must be communicated through "official notices," even if the agreement does not clearly specify the type of notice or the time for issuing such notice. *D.R. Horton*, 207 S.W.3d at 869. There, the court held that "[b]ecause any changes or amendments must be communicated through notice, the promise to arbitrate is not illusory." *Id.*

This is not a situation where Blockbuster can change its contract without notice and deprive Plaintiffs of any opportunity to review the changes or even to know about them. Rather, even though Blockbuster may change its Terms and Conditions at any time, such changes will not affect customers who choose not to accept such changes by terminating their use of Blockbuster's online services. *See* RE5 at CR72; *see also Dillard Dep't Stores*, 198 S.W.3d at 782 (finding that an arbitration agreement was not illusory and that the defendant's new policy had not retroactively amended the old one because "[a]n employer may adopt a new policy or amend an existing one at any time, and the changes will not affect employees who did not receive notice of the changes and accept them") (citing *In re Halliburton Co.*, 80 S.W.3d 566, 568 (Tex. 2002)). As in *Iberia Credit Bureau*, the posting of the change on the Blockbuster website will act as an "invitation" to enter into a contractual relationship governed by the new terms, which Blockbuster Online customers can accept by continuing to use the service. The fact that Blockbuster retains the right to modify its Terms and Conditions prospectively

does ***not*** mean that the existing Terms and Conditions do not bind it. *Iberia Credit Bureau*, 379 F.3d at 174. Accordingly, the change-in-terms provision does not render the Arbitration Clause illusory.[8]

(ii) The district court erred by reading the change-in-terms provision in a way that renders it illusory.

The district court noted that "there is nothing in the Terms and Conditions that prevents Blockbuster from unilaterally changing any part of the contract *other than* providing that such changes will not take effect until posted on the website." RE4 at CR239 (emphasis added). According to the court, "[t]he Blockbuster contract only states that modifications 'will be effective immediately upon posting,' and the natural reading of that clause does not limit application of the modifications to earlier disputes." *Id.* The court's stretch to invalidate this Arbitration Clause violates the United States Supreme Court's clear mandate that arbitration provisions should be evaluated no differently—and certainly no more strictly—than other contractual provisions. *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 457-58 (2003) ("States may regulate contracts, including arbitration clauses, under general contract law principles," but "state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law."); *Volt Info.*

[8] To the extent Blockbuster actually changes the contract and attempts to enforce those changes, the effect and binding nature of the change-in-terms provision can be addressed at that time. ***Blockbuster, however, has not changed the relevant online Terms and Conditions since Plaintiffs became members of Blockbuster Online.***

Scis. v. Leland Stanford Jr. Univ., 489 U.S. 468, 475-76 (1989) ("[i]n applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the [FAA], due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration"); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985) (noting that the purpose of the FAA "was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs'") (internal citation omitted). Accordingly, the Arbitration Clause should be evaluated under general contract principles, paying due regard to the strong federal policy in favor of arbitration.

As a general rule of contract interpretation, contractual provisions should be construed so as to avoid illusory promises. *See Davis-Ruiz v. Mid-Continent Cas. Co.*, 281 Fed. App'x 267, 274 (5th Cir. 2008) (rejecting interpretation of clause in insurance policy because the resulting contract "would have no effect whatsoever, and the coverage it purports to extend would be illusory, and noting that "Texas courts disfavor such constructions"); *Kennewick Irrigation Dist. v. United States*, 880 F.2d 1018, 1032 (9th Cir. 1989) (courts should avoid interpretation that leaves part of a contract illusory); *Great Am. Ins. Co. v. Fed. Ins. Co.*, No. 3:04-CV-2267-H, 2006 WL 2263312, at *7 (N.D. Tex. Aug. 8, 2006) (not designated for publication) (rejecting interpretation of contract that would render one party's

promises "largely illusory"); *Young v. Neatherlin*, 102 S.W.3d at 420 (Tex. App.—Houston [14th Dist.] 2003, no pet.) ("courts strive to construe a contract to promote mutuality and to avoid a construction that makes promises illusory") (citing *Portland Gasoline Co. v. Superior Mktg. Co.*, 243 S.W.2d 823, 824 (Tex. 1951), *overruled on other grounds by Northern Natural Gas Co. v. Conoco, Inc.*, 986 S.W.2d 603 (Tex. 1998)).

For this reason, unless the contract explicitly reserves the right to make modifications retroactively, courts have interpreted contractual termination or modification provisions as applying prospectively only, as such interpretation avoids finding the underlying contract illusory. *See Barker v. Ceridian Corp.*, 122 F.3d 628, 638 (8th Cir. 1997) (where retirement plan was silent regarding whether terms could be modified retroactively, prospective application favored because it avoids finding promise illusory); *Kemmerer v. ICI Ams., Inc.*, 70 F.3d 281, 287-88 (3d Cir. 1995) (holding that "even when a plan reserves to the sponsor an explicit right to terminate the plan, acceptance by performance closes that door under unilateral contract principles," because any other interpretation would render the promises illusory);[9] *Carr v. First Nationwide Bank*, 816 F. Supp. 1476, 1490 (N.D. Cal. 1993) (interpreting an "unlimited amendment clause" as applying prospectively rather than retroactively, because "[a]ny other interpretation of the

[9] The *Kemmerer* court found that the pension plan at issue was a "unilateral contract" which employees could accept by performance. *See* 70 F.3d at 287.

Plan's amendment clause would make the Plan's several specific and mandatory provisions ineffective, rendering the promises embodied therein completely illusory."). As these courts have recognized, it is the right to change a contract ***retroactively*** that must be explicitly preserved—"a contrary rule would lack any basis in contract law." *Amatuzio v. Gandalf Sys. Corp.*, 994 F. Supp. 253, 266 (D.N.J. 1998); *see also Eastman Kodak Co. v. Bayer Corp.*, 369 F. Supp. 2d 473, 479 (S.D.N.Y. 2005), *rev'd on other grounds*, 452 F.3d 215 (2d Cir. 2006) ("[I]t is settled that a 'top-hat' benefit plan may be retroactively amended after participants' rights have vested only if the explicit right to terminate or amend after participants' performance is reserved."). The district court's reasoning simply turned this well-established principle upside down.

Because Blockbuster's change-in-terms provision does not expressly reserve the right to apply modifications retroactively, this clause should be interpreted as applying prospectively only. Interpreting the change-in-terms provision to allow for retroactive modifications, as the district court did, also runs counter to the well-established principle that contracts should be interpreted to avoid "absurd results" or "a construction which is unreasonable, inequitable, and oppressive." *Frost Nat'l Bank v. L & F Distribs., Ltd.*, 165 S.W.3d 310, 312 (Tex. 2005) (per curiam); *see also Reilly v. Rangers Mgmt., Inc.*, 727 S.W.2d 527, 530 (Tex. 1987) (stating that courts should avoid, when possible, a construction that is unreasonable, oppressive

or inequitable). For example, if the change-in-terms provision applied retroactively, Blockbuster could change the price of a transaction already consummated and then send the customer a bill for the additional amount. This reading is completely unsupported by the text of the agreement, was obviously unintended by the parties, and may not be imposed here. The more reasonable interpretation of the change-in-terms provision is provided by the numerous other courts that have held such clauses to apply prospectively only.

In fact, by its terms, the change-in-terms provision is more reasonably read as limiting any modification to prospective application. The provision explicitly states that any changes "will be effective immediately upon posting," making clear that modifications—although immediate—apply "upon" posting and are ***not*** retroactive. *See* RE5 at CR72. The change-in-terms provision is—at worst—silent on whether terms may be modified retroactively. *See* RE5 at CR72, 76. Because this provision does not expressly provide that modifications will apply retroactively, such an effect should not be read into it. Rather, the courts should apply any changes prospectively only in order to avoid a construction that renders the contract illusory and oppressive. *See Barker*, 122 F.3d at 638.

Even if the change-in-terms provision did apply retroactively to the rest of the underlying contract, the Arbitration Clause itself explicitly provides that it applies to "[a]ll claims, disputes or controversies . . . whether pre-existing, present

or future," and "survive[s] the termination of [Plaintiffs'] right to use [the Blockbuster] Site." RE5 at CR75-76. The Arbitration Clause thus requires both parties to the contract to arbitrate any disputes that arise while the arbitration agreement is in effect, even if the Terms and Conditions are subsequently terminated or amended.

This interpretation of the Terms and Conditions makes clear that Blockbuster "cannot avoid its promise to arbitrate by amending the provision or terminating it altogether," *Halliburton*, 80 S.W.3d at 570, and the Arbitration Clause is therefore not illusory. In light of the general rules of contract construction as well as the strong policy in favor of arbitration, the district court clearly erred by reading the Arbitration Clause and the Terms in Conditions in such a way that renders them illusory.

(iii) Plaintiffs' challenge to the form of notice is premature.

Based on the clear language of the change-in-terms provision, Plaintiffs cannot suggest that the Contract allows Blockbuster to effectuate changes without ***any*** notice to the members. Rather, at most, Plaintiffs can quibble about the prescribed ***form*** of the notice.[10] But challenges to the form and adequacy of notice

[10] Texas courts have recognized that different contracts require different forms of notice, and have upheld notice provisions similar to Blockbuster's. For example, the contract at issue in *Martinez v. TX. C.C., Inc.*, No. Civ.A. H-05-3747, 2006 WL 18374 (S.D. Tex. Jan. 4, 2006) (not designated for publication), required employees to "familiarize themselves with the specific terms and conditions of the arbitration policy," which "include[d] amendments that might be

do not result in the nullification of the entire contract. Rather, to the extent Plaintiffs do not believe that Blockbuster's notice procedure provides sufficient notice of changes, they may challenge any such changes if and when they are made (or when Blockbuster seeks to enforce them).

Plaintiffs' argument hinges on the fact that Blockbuster may, theoretically, have the power to change the terms in a way that would render the parties' contract unconscionable. Such an attack, however, is speculative, unfounded, and not ripe. Unlike *Morrison*, the Arbitration Clause at issue here has not been changed since Plaintiffs joined Blockbuster Online. Whether Blockbuster could change its terms in such a way that would render the clause unenforceable can be addressed when—and if—such changes are made. *See Iberia Credit Bureau*, 379 F.3d at 174 ("The fact that the company has the right to change the terms upon notice does not mean that the contract never bound it. Nor does the fact that the companies could later attempt to change the arbitration clause to render it oppressive mean that the arbitration clause, as it stands, is unconscionable.").

(iv) Even if the Terms and Conditions permitted Blockbuster to retroactively change its Arbitration Clause, the clause is not illusory because the applicable arbitration rules prohibit Blockbuster from avoiding its promise

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made from time to time." *Id.* at *3. The court held that the change-in-terms provision did not render the contract illusory, as the arbitration policy was made "available" to the employees by keeping a copy in the office. *Id.* Similarly, in this case, Plaintiffs agreed to "review the[] Terms and Conditions periodically" when they signed up for Blockbuster Online.

to arbitrate by retroactively amending the Arbitration Clause.

Finally, the Arbitration Clause provides that arbitrations initiated thereunder will be "administered by the American Arbitration Association under its rules for the resolution of consumer-related disputes." RE5 at CR75. Therefore, even if Blockbuster ***could*** retroactively change its arbitration provision and apply such changes to already-initiated proceedings, such a change would be invalidated by the rules of the American Arbitration Association (the "AAA").

In *Champion Technologies*, the contract at issue contained a change-in-terms provision that appeared to allow the defendant to amend the rules at any time without notice. 222 S.W.3d at 133. The court, however, found that the arbitration agreement was not illusory where arbitrations initiated pursuant to that agreement would be administered by the AAA: the defendant "cannot avoid its promise to arbitrate by amending the Rules because the rules of the AAA would nullify the offending amendments." In this case, as in *Champion Technologies*, the change-in-terms provision does not render the Arbitration Clause illusory because the rules of the AAA would nullify any offending change.

III. NEITHER THE TERMINATION PROVISION NOR THE LIMITATION-OF-LIABLITY PROVISION RENDERS THE TERMS AND CONDITIONS ILLUSORY

The district court's decision rested entirely on the change-in-terms provision, and did not address the effect of the termination provision or the

limitation-of-liability provision on the Terms and Conditions. However, because Plaintiffs erroneously argued below that these provisions also render the Terms and Conditions illusory, Blockbuster addresses these claims here out of an abundance of caution.[11]

A. The Termination Provision Does Not Render The Terms and Conditions—Or The Arbitration Clause Contained Therein—Illusory.

As discussed in Section II(A), *supra*, Plaintiffs' attempts to avoid arbitration based on challenges to the contract as a whole should fail for the independent reason that such challenges are beyond the scope of the motion to compel arbitration. "[C]hallenge[s] to the validity of the contract as a whole," including Plaintiffs' claim that the termination provision renders the Terms and Conditions illusory, "must go to the arbitrator." *Buckeye Check Cashing*, 546 U.S. at 449.

But even if a federal court could consider Plaintiffs' challenge to the termination provision in Blockbuster's Terms and Conditions, that provision also does not render the underlying contract illusory. A termination provision will not render an arbitration agreement illusory where, as here, the obligation to arbitrate is not extinguished upon termination of the underlying contract. *See Nabors Wells Servs., Ltd. v. Herrera*, Nos. 13-08-00397-CV, 13-08-00451-CV, 2009 WL

[11] In addition to the reasons set forth below, the termination and limitation-of-liability provisions do not render the Arbitration Clause illusory for the reasons set forth in sections (II)(B)(1) and (II)(B)(2), *supra*.

200987, at *5 (Tex. App.—Corpus Christi Jan. 27, 2009, no pet.) (not designated for publication) (finding that an arbitration agreement was not illusory because, among other things, a termination would not affect proceedings which had already been initiated, and therefore, the defendant could not unilaterally avoid its promise to arbitrate); *In re Golden Peanut Co.*, 269 S.W.3d 302, 309 (Tex. App.—Eastland 2008, orig. proceeding [mand. pending]) (where the right to terminate applied prospectively only, arbitration agreement was not illusory); *Halliburton*, 80 S.W.3d at 569-70 (rejecting the argument that the arbitration agreement at issue was illusory because it required ten-days notice of any modification or termination and stated that any such amendment would apply prospectively only, and thus, Halliburton could not "avoid its promise to arbitrate by amending the provision or terminating it altogether").

Although Blockbuster has the right to terminate a party's right to use its website, the Arbitration Clause contains a "savings clause" which provides that "[t]his provision shall survive the termination of your right to use this Site." RE5 at CR76. The Texas Supreme Court already considered a similar case, where a contract containing an arbitration agreement also included a termination provision and a savings clause that stated: "Notwithstanding the termination of this Agreement, . . . any obligations that arise prior to the termination of the Agreement shall survive such termination." *See AdvancePCS*, 172 S.W.3d at 607. The

AdvancePCS court held that the termination provision did not render the arbitration agreement illusory due to this savings clause, noting that "[h]ad the [plaintiffs] invoked arbitration rather than filing suit, [the defendant] could not have avoided arbitration by terminating the Provider Agreement," and thus, "the clause was not illusory." *Id.* at 607-08.

Because of this savings clause, Blockbuster, like the defendant in *AdvancePCS*, cannot avoid its obligation to arbitrate by terminating the underlying contract. The savings clause makes clear that here, as in *Halliburton*, Blockbuster's promise to arbitrate is not dependent on Plaintiffs' continued membership in the Blockbuster Online program. 80 S.W.3d at 569 (rejecting the argument that an arbitration agreement was illusory because Halliburton's promise to arbitrate was not dependent on the plaintiffs' continued employment). Accordingly, the termination provision does not render the Arbitration Clause illusory.

B. The Limitation-Of-Liability Provision Does Not Render The Terms And Conditions Illusory.

As discussed in Section II(A), *supra*, Plaintiffs' attempts to avoid arbitration based on challenges to the contract as a whole should fail for the independent reason that such challenges are beyond the scope of the motion to compel arbitration. Plaintiffs argued below that "the ***entire contract*** is illusory and a nullity" as a result of the limitation-of-liability provision in the Terms and

Conditions. CR107-10 (emphasis in original). "[C]hallenge[s] to the validity of the contract as a whole," such as this one, "must go to the arbitrator." *Buckeye Check Cashing*, 546 U.S. at 449. Because this claim is clearly an attack on the Terms and Conditions as a whole, there is no basis for considering it here.

Even if the court could consider Plaintiffs' challenge to the limitation-of-liability provision, that provision also does not render the Terms and Conditions a nullity. The limitation-of-liability provision explicitly provides that it shall apply ***only*** "TO THE FULLEST EXTENT PERMITTED BY LAW." RE5 at CR75. This limiting language prevents Blockbuster from limiting its liability to the extent such limitation may conflict with applicable law. Accordingly, this provision does not render the Terms and Conditions illusory. *See Coleman*, 2003 WL 22388482 at *3 (holding that contract was not illusory because contested provision only applied "to the fullest extent permitted by law").[12] Accordingly, the limitation-of-

[12] Moreover, even if the limitation-of-liability provision did not include the language noted above, this provision does not render the Terms and Conditions illusory because it does not exclude Blockbuster from all liability, but merely limits remedies, including certain kinds of damages. Limitation-of-liability provisions that merely limit remedies do not render the underlying contract unenforceable. *See Orion Refining Corp. v. UOP*, 259 S.W.3d 749, 763 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); *Universal Computer Consulting Holding*, 2005 WL 2149508 at *5; *Gililland v. Taylor Invs.*, No. 11-03-00175-CV, 2004 WL 2126755, at *4 (Tex. App.—Eastland Sept. 23, 2004, pet. denied) (not designated for publication). In contrast, the only case relied on by Plaintiffs on this issue involved a contractual provision which stated that the defendant "shall not be liable for its failure to profide [sic] the services herein," and the court therefore found that the defendant "would not be liable for an outright refusal" to perform the services contracted for. *Sterling Computer Sys. of Tex., Inc. v. Tex. Pipe Bending Co.*, 507 S.W.2d 282, 282 (Tex. Civ. App.—Houston [14th Dist.] 1974, writ ref'd).

liability provision does not affect the validity or enforceability of the Arbitration Clause.

C. Even If The Challenged Provisions Do Render The Terms and Conditions Illusory, The Challenged Provisions Can Be Severed From The Remaining Terms and Conditions, Thus Leaving The Arbitration Clause Valid And Enforceable.

Plaintiffs have challenged the enforceability of the Terms and Conditions and the Arbitration Clause based on provisions which Blockbuster is not seeking to enforce and which are not otherwise at issue in this case. Therefore, these provisions, to the extent they are determined to render the Terms and Conditions and/or the Arbitration Clause illusory, should be severed for purposes of this dispute. Blockbuster's Terms and Conditions include a severability clause, which provides as follows:

> If any provision of this Agreement or part thereof is or becomes illegal, invalid or unenforceable in any jurisdiction, the illegality, invalidity or unenforceability of that provision will not affect the legality, validity or enforceability of the remainder of the provision or the remaining provisions of this Agreement, as the case may be, or the legality, validity or enforceability of that provision or part thereof in any other jurisdiction.

RE 5 at CR76.

Under Texas law, "[a]n illegal or unconscionable provision of a contract may generally be severed so long as it does not constitute the essential purpose of the agreement." *In re Poly-America, L.P.*, 262 S.W.3d 337, 360 (Tex. 2008)

(citing *Williams v. Williams*, 569 S.W.2d 867, 871 (Tex. 1978)). Whether or not the invalidity of one provision in a contract affects the rest of the contract depends upon whether the remaining provisions are "independent or mutually dependent promises," which courts determine by looking to the language of the contract itself. *Id.*; *John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80, 86 (Tex. App.—Houston [14th Dist.] 1996, writ denied) (citing *Hanks v. GAB Bus. Servs., Inc.*, 644 S.W.2d 707, 708 (Tex. 1982)). If the parties would have entered into the agreement absent the unenforceable provisions, such provisions can properly be severed from the rest of the agreement. *Poly-America*, 262 S.W.3d at 360; *Patrizi v. McAninch*, 269 S.W.2d 343, 348 (Tex. 1954); *see also City of Beaumont v. Int'l Ass'n of Firefighters, Local Union No. 399*, 241 S.W.3d 208, 215 (Tex. App.—Beaumont 2007, no pet.) (citing *Rogers v. Wolfson*, 763 S.W.2d 922, 925 (Tex. App.—Dallas 1989, writ denied)); *Stroman*, 923 S.W.2d at 86 (citing *Frankiewicz v. Nat'l Comp. Assocs.*, 633 S.W.2d 505, 507-08 (Tex. 1982)). Texas courts have previously allowed severance of contract provisions where those provisions were "only a part of the many reciprocal promises in the agreement" and "did not constitute the main or essential purpose of the agreement." *Poly-America*, 262 S.W.3d at 360 (citing *Williams*, 569 S.W.2d at 871).

The severability clause in Blockbuster's Terms and Conditions makes clear that the parties intended that illegal and illusory contractual provisions be excised,

at least where those provisions are not being enforced and are not otherwise at issue. One key purpose of the Terms and Conditions is for the parties to submit their disputes to an arbitral forum rather than to proceed in court. This purpose is not undermined—and is in fact bolstered—by severing illusory or otherwise unenforceable provisions that Blockbuster is not seeking to enforce from the overall contract. *See Poly-America*, 262 S.W.3d at 360; *see also Carter v. Countrywide Credit Indus., Inc.*, 189 F. Supp. 2d 606, 620 (N.D. Tex. 2002), *aff'd*, 362 F.3d 294 (5th Cir. 2004) (invalidating an unconscionable fee-splitting arrangement within a contract but enforcing the rest of the arbitration agreement pursuant to a severability clause); *Jones v. Fujitsu Network Commc'ns, Inc.*, 81 F. Supp. 2d 688, 693 (N.D. Tex. 1999) (same); *see also Gililland*, 2004 WL 2126755 at *5 (indicating that a severability clause, providing that "[i]f any provisions of [the agreement] are held to be invalid, illegal, void or unenforceable by reason of any law . . . all other provisions shall nevertheless remain in full force and effect," served as an alternative basis for finding that a change-in-terms provision did not render an arbitration agreement illusory).

Therefore, to the extent the Court finds that the change-in-terms provision, the termination provision, and/or the limitation-of-liability provision render the Terms and Conditions illusory, unenforceable, or unconscionable, there is a remedy: in light of the fact the parties evidenced an intent to sever illegal

provisions in the Terms and Conditions, and the fact that Blockbuster is not seeking to enforce any of these provisions here, these provisions—which clearly do not constitute "the main or essential purpose of the agreement"—should be severed from the underlying contract.

IV. PLAINTIFFS' CONTRACT FORMATION AND UNCONSCIONABILITY ATTACKS ON THE ARBITRATION CLAUSE HAVE NO MERIT

Plaintiffs argued below that the Arbitration Clause was not valid because Blockbuster has not proven that Plaintiffs consented to the online Terms and Conditions and that the Arbitration Clause is procedurally and substantively unconscionable. Although the district court did not consider these arguments, Blockbuster addresses them here out of an abundance of caution. For the reasons below, Plaintiffs' arguments fail.

A. Plaintiffs Agreed To Be Bound By The Terms And Conditions, Including The Arbitration Clause.

Plaintiffs argued that the Arbitration Clause was not valid because "Blockbuster Has Not Showed [sic] Sufficient Manifestation of Assent." *See* CR110-11. Plaintiffs' argument, however, ignores the undisputed evidence that they already provided clear manifestation of consent. During the Blockbuster Online sign-up process, Plaintiffs were required to "click" on a box, affirmatively representing that they had read and accepted Blockbuster's Terms and Conditions, which were available by hyperlink next to the box. *See* RE5 at CR68-69. As

explained in the Declaration of Jennifer L. Dineen, Plaintiffs could not have completed the sign-up process for Blockbuster Online memberships without clicking on the box next to the statement:

> I have read and agree to the blockbuster.com (including BLOCKBUSTER Online Rental) **Terms and Conditions** . . . .

See RE5 at CR68-70.

This type of agreement, often referred to as a "clickwrap" agreement, is regularly enforced by Texas courts. For example, in *Barnett v. Network Solutions, Inc.*, 38 S.W.3d 200, 204 (Tex. App.—Eastland 2001, pet. denied), the court enforced a clickwrap agreement like the one at issue here, stating that "[i]t was [the plaintiff's] responsibility to read the electronically-presented contract, and he cannot complain if he did not do so." Similarly, in *Recursion Software, Inc. v. Interactive Intelligence, Inc.*, 425 F. Supp. 2d 756, 782-83 (N.D. Tex. 2006), the court analyzed clickwrap agreements and concluded that they "are valid and enforceable contracts." *See also Fieldtech Avionics & Instruments, Inc. v. Component Control.com, Inc.*, 262 S.W.3d 813, 818 n.1 (Tex. App.—Fort Worth 2008, no pet.) ("Texas courts recognize the validity of clickwrap agreements.").[13]

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[13] Courts outside of Texas, applying Texas law, have similarly enforced clickwrap agreements. For example, in *Davis v. Dell, Inc.*, No. 07-630 (RBK), 2007 WL 4623030, at *4 (D.N.J. Dec. 28, 2007), *aff'd*, No. 07-630 (RBK), 2008 WL 3843837 (D.N.J. Aug. 15, 2008) (not designated for publication), the court held, under Texas law, that "a party may manifest assent to a contract by clicking on an "I Accept" button in connection with an internet transaction." Similarly, in *Hubbert v. Dell Corp.*, 835 N.E.2d 113 (Ill. App. Ct. 2005), the court, applying Texas law,

Below, Plaintiffs attempted to distinguish these cases on the ground that Blockbuster's Terms and Conditions are displayed by hyperlink and do not require the user to actually scroll through the terms. The defining feature of a clickwrap agreement, however, is the fact that it requires an affirmative manifestation of assent (a "click"), not the way in which a user accesses and reviews its terms. *See American Eyewear, Inc. v. Peeper's Sunglasses & Accessories, Inc.*, 106 F. Supp. 2d 895, 904 n.15 (N.D. Tex. 2000) (noting that "[a] 'clickwrap agreement' allows a customer to assent to the terms of a contract by selecting an 'accept' button on the website. If the consumer does not accept the terms of the agreement, the web site will not complete the transaction"); *see also Southwest Airlines Co. v. BoardFirst, L.L.C.*, No. 3:06cv0891-B, 2007 WL 4823761, at *4 n.4 (N.D. Tex. Sept. 12, 2007) (not designated for publication) (distinguishing "browsewrap" agreements from "clickwrap" agreements on the basis that clickwrap agreements require the user expressly to manifest consent by clicking "yes" or "I agree").

A Texas federal district court has already rejected the exact argument Plaintiffs make here. In *RealPage, Inc. v. EPS, Inc.*, 560 F. Supp. 2d 539 (E.D. Tex. 2007), the court was presented with a clickwrap agreement similar to the one at issue in this case, where users were not required to scroll through the agreement

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enforced a clickwrap agreement, noting that the company's terms and conditions appeared via hyperlink during the ordering process, and finding that a computer user would have known to click on the hyperlink to access the terms and conditions. *Id.* at 121.

before being allowed to indicate acceptance. *See id.* at 545. The court held that this type of clickwrap agreement was valid and enforceable. *See id.*

For these reasons, Plaintiffs' argument that there is insufficient evidence that they agreed to be bound by the Terms and Conditions has no merit and should be rejected.

B. The Arbitration Clause Is Not Unconscionable And Should Be Enforced.

Plaintiffs also argued below that the Arbitration Clause should be declared invalid and not binding because it is unconscionable. Under Texas law and the FAA, Plaintiffs, as the party opposing arbitration, bear the burden of proof with respect to unconscionability. *See In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 756 (Tex. 2001).

Under Texas law, "the basic test for unconscionability is whether, given the parties' general commercial background and the commercial needs of the particular trade or case, the clause is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract." *FirstMerit Bank*, 52 S.W.3d at 757. This principle is designed to prevent unfair surprise and oppression, not to disturb the allocation of risks due to superior bargaining power. *Id.* In Texas, the doctrine of unconscionability has two components—procedural and substantive—and Plaintiffs must establish both. *In re Halliburton Co.*, 80 S.W.3d at 571; *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190, 198 (Tex.

App.—Houston [14th Dist.] 2003, no pet.). Procedural unconscionability "refers to the circumstances surrounding the adoption of the arbitration provision," whereas substantive unconscionability "refers to the fairness of the arbitration provision itself." *Halliburton*, 80 S.W.3d at 571. Plaintiffs cannot meet their burden here.

1. The Arbitration Clause is not procedurally unconscionable under Texas law.

a. Adhesion contracts, if this is one, are not inherently unconscionable.

In evaluating procedural unconscionability, courts look at the circumstances surrounding the arbitration clause's adoption. *Halliburton*, 80 S.W.3d at 571. Plaintiffs may argue that this is a contract of adhesion and therefore procedurally unconscionable. But arbitration clauses contained in adhesion contracts (if this is in fact such a contract, which is disputed) are not inherently unconscionable under Texas law. *Dillard v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 961 F.2d 1148, 1154 (5th Cir. 1992) ("Adhesion contracts are not automatically void. Instead, the party seeking to avoid the contract generally must show that it is unconscionable."); *In re U.S. Home Corp.*, 236 S.W.3d 761, 764 (Tex. 2007) (noting that arbitration agreements in contracts of adhesion are not automatically unconscionable and finding that defendants' refusal to contract with the plaintiffs without an arbitration clause was not sufficient to show unconscionability).

Unequal bargaining power—on its own—is also not sufficient to establish procedural unconscionability. *See Carter*, 362 F.3d at 301 (rejecting reliance on superior bargaining position to establish procedural unconscionability, noting that such an argument "has no support in Texas law"); *Palm Harbor Homes*, 195 S.W.3d at 679 ("The principles of unconscionability do not negate a bargain because one party to the agreement may have been in a less advantageous bargaining position."); *Halliburton*, 80 S.W.3d at 572 (observing that contract provision is not procedurally unconscionable simply because the party with superior bargaining power makes a "take it or leave it" offer, leaving the weaker party with no opportunity to negotiate).

Plaintiffs have not met their burden to show procedural unconscionability. Plaintiffs clearly had "freedom of choice" in entering into their contracts with Blockbuster—they could have refused to accept Blockbuster's Terms and Conditions and chosen to rent movies from another online movie company, such as Netflix, or chosen to rent movies in person. *See Calarco v. Sw. Bell Tel. Co.*, 725 S.W.2d 304, 307 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.) (holding that no fact issue was raised regarding disparity of bargaining power where customer was free to do business with other telephone directory providers), *overruled on other grounds*, *Houston Lighting & Power Co. v. Auchan USA, Inc.*, 995 S.W.2d 668 (Tex. 1999); *see also Lindemann v. Eli Lilly & Co.*, 816 F.2d 199,

203 (5th Cir. 1987) (noting that, in evaluating procedural unconscionability, "a court must look to . . . the alternatives . . . available to the parties at the time of making the contract").[14] For these reasons, Plaintiffs have failed to show that the Arbitration Clause is procedurally unconscionable.

b. Plaintiffs' failure to read the Terms and Conditions would not render the contract unconscionable.

Finally, Plaintiffs cannot plausibly claim that they could not read or understand the Arbitration Clause. Texas case law holds that the "failure to read the agreement does not excuse [Plaintiffs] from arbitration." *EZ Pawn Corp. v. Mancias*, 934 S.W.2d 87, 90 (Tex. 1996). "The only cases under Texas law in which an agreement was found procedurally unconscionable involve situations in which one of the parties appears to have been ***incapable*** of understanding the agreement." *Fleetwood Enters., Inc. v. Gaskamp*, 280 F.3d 1069, 1077 (5th Cir. 2002) (emphasis added) (citing *In re Turner Bros. Trucking Co.*, 8 S.W.3d 370 (Tex. App.—Texarkana 1999, no pet.) (finding an agreement was procedurally unconscionable where one of the parties was functionally illiterate, nobody explained the agreement to him, and the person who gave him the agreement to

[14] Moreover, some Texas courts have held that even a "lack of choice [i]s not sufficient to establish procedural unconscionability." *In re Farmers & Ranchers Mut. Ins. Co.*, No. 04-08-00128-CV, 2008 WL 2133116, at *2 (Tex. App.—San Antonio May 21, 2008, no pet.) (not designated for publication); *see also Auchan USA, Inc. v. Houston Lighting & Power Co.*, 961 S.W.2d 197, 200-02 (Tex. App.—Houston [1st Dist.] 1996) (even though customers had "no choice" but to enter into adhesion contracts with the defendant—the only provider of electrical service in this area—in order to obtain electrical service, the contracts were enforceable and not against public policy), *rev'd on other grounds*, 995 S.W.2d 668 (Tex. 1999).

sign did not understand the agreement); *Prevot v. Phillips Petroleum Co.*, 133 F. Supp. 2d 937 (S.D. Tex. 2001) (finding procedural unconscionability where the plaintiffs did not speak English and the agreement was not translated or explained to them)). Because Plaintiffs have not argued or presented any evidence showing that they are incapable of understanding the Arbitration Clause, it is not procedurally unconscionable.

c. The Arbitration Clause is sufficiently prominent.

Likewise, Plaintiffs cannot claim that the Arbitration Clause was not sufficiently disclosed to them, particularly given that it appears two short paragraphs under the heading, "DISPUTE RESOLUTION." *See* RE5 at CR75-76. The FAA prohibits states from passing statutes that require arbitration clauses to be displayed with special prominence, and courts cannot use unconscionability doctrines to achieve the same result. *Iberia Credit Bureau*, 379 F.3d at 172 (citing *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 686-88 (1996); *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987)).

This is not a case where an arbitration provision is printed in small type on the back of a form contract. Neither is this a case where the arbitration provision is hidden in a long contract without a descriptive heading. Rather, the Arbitration Clause is preceded by a descriptive heading, with "DISPUTE RESOLUTION" printed in all capital letters. RE5 at CR75. This is sufficient, by itself, to render

the section "conspicuous," as the Texas Supreme Court has held that "***language in capital headings . . . is conspicuous***." *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 511 (Tex. 1993) (emphasis added); *see also Douglas Cablevision IV, L.P. v. Sw. Elec. Power Co.*, 992 S.W.2d 503, 509 (Tex. App.—Texarkana 1999, pet. denied) ("The conspicuous standard can be met by a heading printed in capital letters . . . ."). Moreover, where, as here, an arbitration provision is simply printed in type that is the same size as the rest of the contract, *see* RE5 at CR75-76, it is not unconscionable. *Iberia Credit Bureau*, 379 F.3d at 172 (rejecting the argument that arbitration clauses were unconscionable where they were "not printed in type that is smaller than that generally used in the rest of the contract"); *Reimonenq v. Foti*, 72 F.3d 472, 477 (5th Cir. 1996) (where "the disputed provision [wa]s printed in lettering the same size as the rest of the contract," it was not unconscionable).

For these reasons, Plaintiffs have not met their burden to show that the Arbitration Clause is procedurally unconscionable.

2. The Arbitration Clause is also not substantively unconscionable.

The Arbitration Clause is also not substantively unconscionable. The agreement between Plaintiffs and Blockbuster is fair and reasonable. The

designated arbitration rules—the AAA's Consumer Rules[15]—are well tailored to individual disputes such as this one. Under these rules, Blockbuster bears the burden of paying nearly all of the arbitration fees. Because their individual claims should not likely exceed $10,000, each plaintiff's share of the arbitrator's fees would be limited to $125—less than the filing fee they paid in this case. Such minimal costs are not unconscionable. *See Carter*, 362 F.3d at 300 (holding that it was "impossible" for plaintiffs to demonstrate prohibitive costs under arbitration agreement where their fee burden was limited to $125).

Nor can Plaintiffs contend that the agreement's prohibition on participation in class-action lawsuits and class-wide arbitrations, *see* RE5 at CR75, renders the agreement unconscionable, as Texas law clearly holds that it does not. As Plaintiffs conceded below, Texas courts and federal courts applying Texas law have repeatedly blessed arbitration agreements that contain class-action waivers. In *AutoNation*, a Texas appellate court rejected a plaintiff's challenge to an individual arbitration agreement, noting that class treatment of claims was merely a procedural device, which must bow to the FAA's mandate "to ensure that private agreements to arbitrate are enforced according to their terms." *AutoNation USA*

[15] The Arbitration Clause provides that arbitrations initiated thereunder "will be referred to and determined by binding arbitration governed by the Federal Arbitration Act and administered by the American Arbitration Association under its rules for the resolution of consumer-related disputes, or under other mutually agreed procedures." RE5 at CR75.

Corp., 105 S.W.3d at 199-200. As the *AutoNation* court recognized, "there is no entitlement to proceed as a class action." *Id.* at 200.

Following *AutoNation*, federal courts across the country have uniformly held that individual arbitration agreements like Blockbuster's are valid and fully enforceable under Texas law. *See, e.g.*, *Davis*, 2007 WL 4623030 at *6 ("[T]he Court finds that class action waivers are not unconscionable under Texas contract law."); *Sherr v. Dell, Inc.*, No. 05 CV 10097 (GBD), 2006 WL 2109436, at *7 (S.D.N.Y. July 27, 2006) (not designated for publication) (upholding, under Texas law, an arbitration clause with a class-action waiver, holding that the plaintiff "is not entitled to a class action suit or class-wide arbitration to vindicate the rights of everyone else with a similar problem"); *Provencher v. Dell, Inc.*, 409 F. Supp. 2d 1196, 1204 (C.D. Cal. 2006) (noting that "*AutoNation* is illustrative of how Texas courts are unwilling to strike down an arbitration provision and class action waiver on the ground of unconscionability").

Arbitration clauses with class-action waivers are enforceable even where federal statutory claims are asserted. *See Carter*, 362 F.3d at 297 (rejecting the plaintiffs' claim that the arbitration agreements' class-action waiver deprived them of substantive rights under the Fair Labor Standards Act); *Walker v. Countrywide Credit Indus., Inc.*, No. 3:03-CV-0684-N, 2004 WL 246406 (N.D. Tex. Jan. 15, 2004) (not designated for publication) (granting motion to compel arbitration of

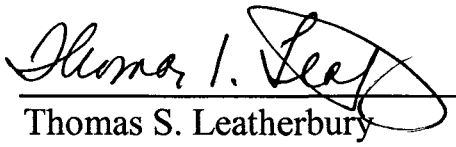
claims brought under the Fair Labor Standards Act and rejecting argument that the arbitration agreement was unconscionable); *Marsh v. First USA Bank, N.A.*, 103 F. Supp. 2d 909, 924 (N.D. Tex. 2000) (rejecting argument that federal statute's remedial purpose would be frustrated by enforcement of a class waiver, finding that the plaintiffs' statutory rights would be "adequately preserved in arbitration, even in the absence of a class action"). Accordingly, the fact that Plaintiffs bring claims under a federal statute—the VPPA—does not render the Arbitration Clause unconscionable, as courts have clearly held that statutory rights are adequately protected in arbitration.

For these reasons, the Arbitration Clause is not substantively unconscionable and should be enforced.

CONCLUSION

For the foregoing reasons, Appellant Blockbuster Inc. prays that this Court reverse the district court's Order denying Blockbuster's Motion to Compel Individual Arbitration and remand with instructions to grant the Motion to Compel Individual Arbitration. Alternatively, Blockbuster prays that this Court reverse and remand for further proceedings consistent with its opinion and grant Blockbuster such other and further relief to which it may be entitled.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I certify that the required number of copies of the Brief of Appellant (both in paper and electronic format) were dispatched to the Clerk of the Fifth Circuit and to the following counsel of record via Hand-Delivery or Federal Express overnight delivery on this, the 26th day of August, 2009:

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1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(b) because this brief contains 13,808 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2003 in 14-point Times New Roman. Footnotes are in 12-point Times New Roman in compliance with 5th Cir. R. 32.1.

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