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No. 85810-1

IN THE WASHINGTON SUPREME COURT
ON CERTIFICATION FROM THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

On Appeal from the United States District Court
for the Western District of Washington at Seattle

No. 10-35228

CHAD MINNICK, *et. al.*,
Appellant,

vs.

CLEARWIRE US, LLC *et al.*,

Respondent.

ANSWER OF APPELLANT TO AMICUS CURIAE BRIEFS OF CTIA – THE WIRELESS ASSOCIATION® AND THE NATIONAL CONSUMERS LEAGUE

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ORIGINAL

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I. INTRODUCTION

The National Consumers League ("NCL"), a 112-year-old consumer advocacy group, and CTIA – The Wireless Association®, an advocacy group that acts on behalf of its members,[1] both submitted *amicus curiae* briefs discussing the effect that Early Termination Fee ("ETF") provisions have on consumers, but ask the Court to reach different conclusions about how Clearwire's ETF should be classified. CTIA's submission espouses ETFs for their alleged benefits to consumers and contends that Appellants are asking this Court to declare that ETFs are unlawful *per se*, to the detriment of consumers, industry and the courts.

But Appellants have never argued that all ETFs are *presumptively invalid* or that they *invariably* harm consumers. Rather, Appellants' position is that Clearwire's contractual provision requiring the payment of an ETF for early termination and for other breaches of contract is a liquidated damages clause, and that, as alleged in the First Amended Complaint, it operates as an unlawful penalty under long-established tests for evaluating such clauses. Moreover, CTIA's assertion that a ruling that Clearwire's ETF is a liquidated damages clause would mark the end of consumer-friendly ETFs, will eliminate choice, and will lead to abusive litigation is also wrong. To the contrary, such a ruling would merely

[1] CTIA's membership includes Clearwire, whose president and CEO serves on CTIA's Board of Directors. *See* www.ctia.org/aboutCTIA/board_of_directors/.

provide for judicial scrutiny of ETFs (which is absent if they are deemed alternative performance provisions) while allowing industry to charge ETFs that do not operate as unlawful penalties.

II. ARGUMENT

NCL argues that because ETFs *can* operate as unlawful penalties and *may* have anticompetitive effects, they should be classified as liquidated damages so that their fairness and reasonableness will not escape judicial scrutiny. CTIA, on the other hand, argues that Clearwire's ETF is an alternative performance provision. NCL's position is correct, and CTIA's, like Clearwire's, is wrong.

A. Appellants Have Never Argued That All ETFs Are *Per Se* Illegal And Have Not Asked The Court To Declare Them To Be "Presumptively Invalid."

CTIA claims that ETFs are necessary features of the fixed-term adhesion contracts that are prevalent in the Internet Service Provider ("ISP") industry (and other industries) and that the rule Appellants promote would render such allegedly beneficial terms "presumptively invalid." CTIA Br. at 15. That is wrong. As they made clear in their Reply Brief, Appellants ask this Court to conclude that ETFs are liquidated damages if: "(a) the fee is imposed upon breach or termination of the contractual relationship; and (b) if the customer cannot obtain return performance from the vendor through payment of the fee." Reply at 2.

Appellants also made clear their view that "[t]hat rule would *not* prohibit vendors from including ETFs in their form contracts; however, it would limit ETFs to amounts that satisfy the well-established standards that have traditionally been applied to liquidated damages," and "would act as a reasonable check on exorbitant ETFs." *Id.*

B. While Ignoring Their Detrimental Effects, CTIA Makes Several Contentions About the Virtues Of ETFs That Would Be Unaffected By A Ruling Classifying Them As Liquidated Damages Clauses.

Setting aside CTIA's attempt to defeat an argument Appellants never made, both NCL and CTIA discuss at length the impact that ETFs have on the suppliers and purchasers of Internet, wireless cell phone and other services. CTIA argues that wireless Internet consumers may "choose from a wide variety of different contract options," (CTIA Br. at 5), yet acknowledges that "an overwhelming majority of U.S. wireless consumers elect traditional post-paid plans for a fixed term (usually one to two years) with an ETF component." *Id.* at 6. While it may be true that Clearwire and other providers offer month-to-month and other plans that do not include an ETF for early cancellation, the record here establishes that, at least for 11 of the 12 Appellants, no such option was made available to them. Reply at 5-7. And, in any event, the fact that Clearwire may offer other contracts that do not charge unlawful penalties for early termination does not validate a contract that does.

Moreover, while CTIA devotes most of its brief to touting the benefits to consumers of ETFs (*see* CTIA Br. at 7-10), as NCL notes: "the vast majority—90% of customers—consider [ETFs] to be penalties to discourage switching companies." NCL Br. at 10 (internal citations omitted). NCL also refers to independent research done by the FCC, which has concluded that "ETFs are seldom well understood by consumers" and that they "affect their decisionmaking regarding switching service providers." *Id.* at 10-11. NCL also points to other studies describing the potential anticompetitive effect of ETFs, which note that as "consumer choice is restricted, companies can avoid providing the highest quality service and lowest-possible rates that would otherwise prevail in a highly competitive industry." *Id.* at 16 (internal citation omitted).

Without citing any evidence, CTIA claims "ETFs generally do not fully compensate service providers for the loss that results when a customer terminates service without making all of the agreed payments." CTIA Br. at 9. The industry's mere *allegation* that ETFs are necessary to recoup costs is no reason to immunize all of these arrangements from the court scrutiny that has traditionally been available for evaluating liquidated damages clauses.

Even *if* CTIA were correct in its assertion that ISPs lose money when a customer ends a fixed-term contract early, then an ETF tied specifically to the amount of that loss—and which is not *in fact* designed to punish the customer for early termination—could possibly meet the test for a valid liquidated damages clause. *See Walter Implement, Inc. v. Focht*, 107 Wn.2d 553, 559-61, 730 P.2d 1340, 1343-44 (1987), *Buchanan v. Kettner*, 97 Wn. App. 370, 373-74, 984 P.2d 1048-49 (1999). At the same time, ISPs like Clearwire would be restricted from doing an end-around the justice system and escaping scrutiny for charging exorbitant ETFs designed merely to (i) keep customers in underperforming contracts, (ii) discourage customers from switching to a different or better service and/or (iii) penalize customers for cancelling their service with the ISP.

CTIA also refers to several alleged benefits to consumers of fixed-term contracts that include ETFs. For example, CTIA claims that entering fixed-term contracts allows consumers to benefit from "lower monthly prices," to "'lock in' a predictable monthly rate for a fixed period" at the "best possible monthly rate," and to have "bigger 'buckets' of minutes" and other benefits. CTIA Br. at 9. In short, CTIA argues that "[g]enerally speaking, carriers can offer better deals and more options and flexibility to their post-paid customers because they have a commitment that those subscribers will remain on the network for the specified period of the contract." *Id.* From the ISP's perspective, CTIA argues, "[t]he assured customer base and the predictable revenue stream associated with term contracts also allows carriers to manage and invest in their networks and improve the quality of their products and services, which ultimately inures to the benefit of consumers." *Id.* at 9-10.

These broad policy arguments—offered by the industry trade association—are untethered from the specific question presented here, and not persuasive in any event. To begin with, these alleged benefits flow from the long-term commitment of ISPs on the one hand to provide high quality service at an attractive price and the consumer's commitment on the other to pay for such services for an extended period. It is that long-term commitment by consumers to pay for the ISP's services—*not* the ability to charge an ETF for early cancellation—that should provide for the predictability of revenues for the ISPs that CTIA claims, in turn, supports the industry's willingness to provide cost savings to consumers.

Moreover, even if the ability to charge an ETF for early termination is a factor in an ISP's willingness to provide cost savings and other benefits to consumers, it does not follow that the ETF should be considered an alternative performance provision as opposed to a liquidated damages clause. Indeed, in a properly functioning industry the mutual commitment between ISPs and consumers would be the same if the ETF is a liquidated damages clause rather than an alternative performance provision. ISPs would still have incentives (indeed, perhaps, more) to be innovative, to develop their networks, and to provide the best possible prices, because those are the features that should encourage consumers to become customers and maintain their relationship with the ISP. Consumers would still be able to "lock in" lower rates and other benefits by signing one or two-year commitments to purchase the ISP's services. A consumer would also know the cost (the liquidated sum) of walking away from the commitment s/he made when s/he has no proper basis to complain about the quality of the service being provided by the ISP.

But if the ETF is deemed to be a liquidated damages clause, and not an alternative performance provision, then the consumer would have the additional benefit of having access to the justice system if the ETF s/he is called upon to pay is unreasonable or operates as a penalty. As NCL notes, the real issue is whether Clearwire's ETF is an alternative performance provision, and thus immune from judicial scrutiny for reasonableness, or a liquidated damages clause, which is not. NCL Br. at 19. Considering both NCL's and CTIA's arguments, this Court should conclude that ETFs in consumer contracts of adhesion are liquidated damages and should be subject to judicial scrutiny under the well-established standards applicable to liquidated damages.

C. CTIA's Legal Arguments Are Wrong.

CTIA devotes several pages of its brief to re-stating legal arguments that Clearwire has already made. These arguments are more fully addressed throughout Appellants' Reply Brief. In short, despite CTIA's and Clearwire's protestations to the contrary, the hallmark of a true alternative performance provision is that payment must be "given in exchange for the return performance by the other party." *Chandler v. Doran*, 44 Wn.2d 396, 401, 267 P.2d 907, 910 (1954) (quoting 5 CORBIN ON CONTRACTS § 1079, AT 379). This is consistent with the view of the leading commentators, on whose opinion CTIA and Clearwire also rely. As *Williston* notes: "[T]he primary object of an alternative contract is performance, and it thus looks to a continuation of the relationship between the parties, rather than to its termination, whereas a liquidated damages provision provides for an agreed result to follow from nonperformance." 24 WILLISTON ON CONTRACTS § 65:7 (4th ed. 2002).

No Washington court has addressed the precise issue presented here, and despite CTIA's contrary argument, the Court should look to *In re Cellphone Fee Termination Cases*, 193 Cal. App. 4th 298, 122 Cal. Rptr. 3d 726 (2011), where the California Court of Appeals addressed the same issue presented here and concluded that the ETF at issue was a liquidated damages clause, and not an alternative performance provision.

Hutchison v. AT&T Internet Serv., No. CV 07-3674 SVW (JCx), 2009 WL 1726344 (C.D. Cal. May 5, 2009), where a federal district court *predicted* what a California court would conclude on the issue, a prediction that turned out to be wrong, is not helpful to the Court's analysis. The other cases on which CTIA relies, including California decisions that pre-date *In re Cellphone Fee Termination Cases*, and *Bellevue School District v. Bentley*, 38 Wn. App. 152, 155, 684 P.2d 793 (1984), are also not helpful to Clearwire's cause.

To begin with, in each of those cases the party demanding performance had already fully performed its end of the bargain. And, in *Bentley*, the provision at issue actually contemplated a continuation of the relationship between the school district and the teacher, by way of her coming back to teach her class after her sabbatical, while at the same time providing a mechanism to end it (her paying money back to the school district). 38 Wn. App. at 154, 684 P.2d at 795. Here, not only is the ETF imposed even when Clearwire has not fully provided the contracted-for services (wireless Internet service for one or two years), but the provision itself never contemplates the continuation of the parties' relationship.

As this Court reasoned in *Chandler*, whether Clearwire's ETF is a liquidated damages clause or an alternative performance provision should not turn on the *form* of agreement, but on the *substance* of the clause. 44

Wn.2d at 400. While NCL was referring to ETFs in general, its argument applies equally to the issue before this Court:

> [B]y any realistic measure of the substance of these arrangements, [ETFs] are—viewed in the *most favorable* realistic light—a form of liquidated damages applicable when a customer brings a contractual relationship (and the parties' reciprocal obligations) to an end before a specified term has expired.

NCL Br. at 3. NCL is correct on this point, and CTIA is wrong.

D. A Ruling That Clearwire's ETF Is A Liquidated Damages Clause Will Not Be Difficult For ISPs To Meet In Setting ETFs And Will Not Encourage Abusive Litigation.

CTIA argues that if the Court were to conclude that Clearwire's ETF is a liquidated damages clause then ETFs would essentially be outlawed to the detriment of consumers. But, as explained above, a ruling that Clearwire's ETF is a liquidated damages clause will not outlaw ETFs, nor is that what Appellants are advocating. CTIA's suggestion that ETFs must be classified as alternative performance provisions or else the alleged benefits of them to consumers will be lost is also wrong, as is likewise discussed above.

CTIA also claims that there will be other negative unintended consequences, including making it difficult, if not impossible, for ISPs to design ETFs that meet applicable law and that it will lead to the abuse of the class action mechanism. CTIA Br. § II.C. These arguments are also wrong for at least the following reasons.

First, CTIA argues that if ETFs are classified as liquidated damages then "industries would rarely be able to predict what ETFs would ultimately be found to meet the test for determining the validity of liquidated damages." CTIA Br. at 16. This argument is difficult to comprehend, as liquidated damages clauses and the tests for determining their validity have existed for centuries. And, in fact, the test for determining the enforceability of a liquidated damages clause includes a consideration of the difficulty in ascertaining the harm caused by nonperformance. *See Focht*, 107 Wn.2d at 559, 730 P.2d at 1343-44 (describing the two-part test for a valid liquidated damages clause as follows: "First, the amount fixed must be a reasonable forecast of just compensation for the harm that is caused by the breach. Second, the harm must be such that it is incapable or very difficult of ascertainment."). If the clause fails either of these two parts, then it "must be considered as a 'penalty' rather than a stipulated 'liquidated damage.'" *Id.* at 561; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 356(1).

Second, CTIA's argument that a ruling that ETFs are liquidated damages, and therefore subject to court challenge, will lead to frivolous lawsuits is without merit. To begin with, a ruling from this Court in line with *In re Cellphone Fee Termination Cases* will help eliminate any lingering confusion over the proper legal classification of ETFs in consumer contracts of adhesion, and streamline any future litigation over this issue. Moreover, the fact that *In re Cellphone Fee Termination Cases* has now been in litigation more than eight years and is going back to the trial court to determine Sprint's true damages does not encourage class action practice for the plaintiffs' bar, which almost always shoulders the high cost and risk of litigating such cases. Finally, CTIA's argument that a court's adopting a particular rule of law might lead to the filing of some unmeritorious claims can be made in virtually every case, and is not a valid reason for the Court to refuse to classify Clearwire's ETF as what it truly is, a liquidated damages clause.

III. CONCLUSION

For the reasons stated herein, and in the Opening Brief and Reply of Appellant, the Court should answer the certified question by declaring the clause at issue to be a liquidated damages clause.

Dated: October 28, 2011

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I certify that on the 28th day of October, 2011, a copy of this document was sent as stated below.

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