No. 85810-1

CHAMBERS, J. (dissenting) — The fundamental difference between liquidated damages and an alternative performance provision is that an alternative performance is intended by the parties—both parties—to be a real choice, while a liquidated damages provision is meant to be a device to ensure performance. Clearwire's contract is an adhesion contract "signed" on line by its customers clicking a "yes" button. Clearwire asks us to believe that the fee it imposes on those who want out of the contract (or who breach the contract) is not intended as a device to ensure performance. With all due respect to my learned colleagues of the majority, the majority comes to an erroneous conclusion because it frames the issue wrongly. The majority states, "Here, a 'real option' exists because at the time of contracting Appellants did not know whether they would want to honor the contract for the fixed term or cancel early." Majority at 7. Thus, the majority concludes there was a choice between performing the contract and paying the early termination fee. If that were the correct way of examining the issue, contracting parties could always be said to have a choice between performance or canceling and paying a fee, and no early termination fee would ever be liquidated damages. Because I would hold that the early termination fees in this case are liquidated damages, not an alternative performance option, I dissent.

FACTS

Clearwire is an Internet service provider. When customers sign up with Clearwire, they may choose month-to-month service or they may contract for a year or more. If customers choose a year or more, they agree to pay a monthly fee for the entire term of the contract. These contracts also contain a provision called an early termination fee (ETF). Under the contract, the ETF must be paid by customers who wish to terminate their service before the contract period expires. Depending on the particular contract the customer signed, the ETFs at issue here come in three basic varieties: a flat $180 ETF, a diminishing $220 ETF, and a diminishing $120 ETF. The $180 ETF is greater than the remaining payments on the contract for the last four months of the contract term. The $220 ETF is greater that the remaining payments for the last three months. The $120 ETF is never greater than the remaining monthly payments. Clearwire may also demand the ETF upon a material breach by the customer.[1]

In a class action currently before the Ninth Circuit Court of Appeals,

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[1] We did not receive a record apart from briefs in this case. However, according to the appellants' brief, the $180 ETF clause stated:

> "If your Internet Access Service was activated with a contract term prior to March 1, 2007 and you terminate that Service for any reason, including relocation outside a coverage area, or **that Service is terminated by Clearwire for any violation by you of the Agreement prior to the end of the Initial Term or any Renewal Term, as applicable, you will be liable for an early termination fee of $180."**

Opening Br. of Appellants at 14 (emphasis in original) (quoting exhibit A to complaint). This language is undisputed, as is the claim that Clearwire may demand any of the ETFs upon material breach by the customer.

Clearwire customers assert that the ETF provisions in Clearwire's contracts are liquidated damages provisions. Such provisions are subject to a penalty analysis to determine whether the ETFs are in fact illegal penalties. Clearwire counters that the ETFs are alternative performance provisions, which are not subject to an illegal penalty analysis. The Ninth Circuit has certified the question to this court.

ANALYSIS

A. *Liquidated Damages and Alternative Performance Provisions*

Only one case from this court addresses alternative performance provisions. *Chandler v. Doran Co.*, 44 Wn.2d 396, 267 P.2d 907 (1954).[2] There, a company hired a manager, Benson Chandler, to operate one of its plants in Oakland, California. *Id.* at 398. In exchange for his services, Chandler received a salary and an option to buy the Oakland plant. But the contract gave the company a choice—if Chandler exercised his option, the company could (a) sell the property or (b) pay Chandler more money. *Id.*

The twist in the case was that the contract was an oral contract, and so the option was in fact unenforceable. *Id.* at 400, 402-03. When Chandler tried to exercise his option, the company refused, presumably noting that the option was

[2] One case from the Court of Appeals has also addressed the issue. *Bellevue Sch. Dist. No. 405 v. Bentley*, 38 Wn. App. 152, 684 P.2d 793 (1984). There, a teacher's contract provided for a paid sabbatical in exchange for either (a) returning to work for two years afterward or (b) repaying the salary paid during sabbatical. *Id.* at 156. The court noted that the teacher was presented with a real choice because she may not have known at the time of contracting whether she wanted to return to her job or not. *Id.* It also asserted that the two options were reasonably related. *Id.* Based on these two observations, it upheld the repayment provision as a true alternative. *Id.* The Court of Appeals' analysis is less than thorough and does not offer any particular insight into how the present case should be resolved.

unenforceable. *Id.* at 399. When he tried to get the money they agreed he would receive if the company chose not to sell, the company claimed that part of the agreement was a liquidated damages provision on an unenforceable option and so also not enforceable. *Id.* at 402-03. Chandler argued that "'where a contract contains two promises in the alternative, one of which is within the Statute of Frauds and one of which is not, recovery may be had for breach of that which is not.'" *Id.* at 400 (quoting uncited source, presumably plaintiff's brief). We held that the agreement for payment of money was enforceable as an alternative promise. *Id.* at 403. This holding obviously avoided an extremely unjust result.

In fleshing out the concept of an alternative performance provision, or alternative contract, as opposed to liquidated damages, we relied entirely upon the famous contract treatises of Corbin and Williston. We defined an alternative contract as "'one in which a party promises to render some one of two or more alternative performances either one of which is mutually agreed upon as the bargained-for equivalent given in exchange for the return performance by the other party.'" *Id.* at 401 (quoting 5 Arthur Linton Corbin, Corbin on Contracts § 1079, at 379 (1951)). We noted that distinguishing the two kinds of provisions is "a problem which the text writers seem to agree is puzzling, and upon which the decided cases are in conflict. It must be solved as a question of factual interpretation, and the form of words used by the parties is not controlling." *Id.* We continued:

> "A contract may give an option to one or both parties either to perform a specified act or to make a payment; and though this form of contract cannot be used as a cover for the enforcement of a penalty, yet

> if on a true interpretation it appears that it was intended to give a real option (that is, that it was conceived possible that at the time fixed for performance, either alternative might prove the more desirable), the contract will be enforced according to its terms. The fact that a promise is expressed in the alternative, however, may easily be given too much weight. As the question of liquidated damages or penalty is based on equitable principles, it cannot depend on the form of the transaction, but rather on its substance. It follows that a contract expressed to be in the alternative when examined in the light of the existing facts may prove to be (1) a contract contemplating a single definite performance with a penalty stated as an alternative, (2) a contract contemplating a single definite performance with a sum named as liquidated damages as an alternative, or (3) a contract by which either alternative may prove the more advantageous and is as open to the promisor as the other. A contract may belong to the third class even though the term 'liquidated damages' is applied in the contract to one alternative. But the fact that a contract appears from its terms to belong to the third class does not prove that it does not belong to the first."

Id. at 401-02 (quoting 3 Samuel Williston, A Treatise on the Law of Contracts § 781, at 2194 (rev. ed. 1936)).

Finally, we pointed out that the lengthy negotiations and the magnitude of the transaction were such that a decision could not have been reached by the parties "without thorough study." *Id.* at 403. This, combined with the fact that we could not "say that the relative values of the alternatives are so disproportionate as to be unequal," convinced us that the contract contained an alternative performance provision. *Id.* at 404.

B. Clearwire's ETFs Are Liquidated Damages

Applying the principles stated in *Chandler* and the treatises upon which it relies, I would hold the ETF provisions in this case are more like liquidated damages than an alternative performance option. First, the contract allows the same ETF to be imposed unilaterally by Clearwire upon either termination of the contract by the customer or breach by the customer. A fee imposed upon breach is by definition a liquidated damages provision. 24 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 65:7, at 263 (4th ed. 2002) ("a liquidated damages provision provides for an agreed result to follow from nonperformance"). Clearwire wants it both ways; when challenged by a customer, the ETFs are alternative performance provisions, but when imposed by Clearwire for breach, they are liquidated damages.

The problem is not solved by Clearwire's argument that it did not impose an ETF for breach in this particular case. Br. of Def./Appellee Clearwire US, LLC, at 36-39. Given that our goal is to determine whether Clearwire's contract contains a true alternative promise, examining the actual terms of the contract is the best way to determine the true nature of the ETF. Under the actual terms of the contract, the ETF can be imposed unilaterally by Clearwire upon a breach of the contract; this fact tips the scales heavily toward liquidated damages.

Second, when both alleged "alternative performances" in a contract are the payment of money, and one is a payment of a lump sum to escape further payments under the contract, common sense dictates that the lump sum is a liquidated

damages provision. There is no meaningful difference between a customer "terminating" the contract and the customer simply ceasing to pay its agreed monthly payments, and thus breaching the contract. *See Mau v. L.A. Fitness Int'l, LLC*, 749 F. Supp. 2d 845, 849 (N.D. Ill. 2010) (holding that such a situation would "more fairly be classified as nonperformance . . . rather than alternative performance"). In either instance, Clearwire would charge an ETF, and in either instance, the ETF is best classified as a liquidated damages provision.

Third, one of the defining characteristics that distinguishes alternative performance from liquidated damages is that "[i]n an alternative contract, either of two performances may be given by the promisor and received by the promisee as the agreed exchange for the return performance by the promisee." 24 Williston, *supra*. This hews closely to the definition from Corbin we relied on in *Chandler*: "'two or more alternative performances either one of which is mutually agreed upon as the bargained-for equivalent given in exchange for the return performance by the other party.'" *Chandler*, 44 Wn.2d at 401 (quoting 5 Corbin, *supra*). The ETFs in this case do not match either of these definitions. For one thing, the contracts are not mutually agreed upon in a bargained-for exchange. They are boiler plate adhesion contracts presented in take-it-or-leave-it form. More importantly, the alternatives are not given in exchange for a single return performance. The point of the "alternative" is that the promisor may choose which performance to give in exchange for the same consideration. *Id.* Clearwire's customers do not receive a year of service in exchange for either the ETF or their monthly payments. If

customers end up paying the ETF, they get literally nothing in exchange.

Fourth, a true alternative performance "looks to a continuation of the relationship between the parties, rather than to its termination." 24 Williston, *supra.* That is manifestly not the purpose of the ETFs in this case. The ETF is imposed upon termination of the relationship. That sounds more like a liquidated damages provision, which "provides for an agreed result to follow from nonperformance." *Id.*

Fifth, an alternative contract must present a real option; in other words, the values of the two performance options must be relatively equal. *Chandler*, 44 Wn.2d at 404. Contrary to Clearwire's assertions, the ETF is not relatively equal to the monthly payments. For several months, the ETF is more expensive than the remaining payments on the contract. We have said that a real option exists where, "'*at the time fixed for performance*, either alternative might prove the more desirable.'" *Id.* at 401 (emphasis added) (quoting 3 Williston, *supra*). In the last few months, the ETF can be significantly more expensive than the monthly payment, and thus at the time fixed for that performance, the ETF could never prove more desirable.

Moreover, there is a serious flaw in Clearwire's reasoning on this point. The ETF is not paid as an alternative in exchange for Clearwire's service. Instead, the customer pays the ETF and receives *no* Internet service in exchange. As discussed above, that alone should be enough to convince the court that this is not a true alternative contract. But it also skews the value calculations. A customer

terminating the contract will have not only paid the monthly fee for Internet service up to the point of termination, but also the ETF. Under Clearwire's reasoning, a customer that cancels in the first month and pays the ETF is exercising a "real option" because the ETF is so much cheaper than the remaining payments. But it seems that the customer's "real option" in that instance results in paying both the monthly fee and the ETF (around $220) for one month of Internet service.

It is true that some of the treatises use language suggesting that some alternative performance provisions can be "the agreed price of the privilege of not performing the promise." 11 Joseph M. Perillo, Corbin on Contracts: Damages § 58:18, at 508 (rev. ed. 2005). But even then, an alternative performance "operates as the full performance by the promisor of the agreed exchange for what may have been promised in return." *Id.* at 509. Clearwire's ETFs are not true alternative performance provisions under this rubric.

Moreover, courts examining this question "must determine whether the parties *actually bargained* for an option. . . . If the clause was inserted *at the request of the party who wishes to discharge the contract by payment*, it is likely that an option was intended." *Id.* at 505 (emphasis added) (footnote omitted). Our case law agrees with this assessment. In upholding the provision as an alternative one in *Chandler*, we said:

> From the pleading, it appears that the parties conducted lengthy negotiations before the oral agreement was reached. It also is apparent that the transaction was one of considerable magnitude, and of such a nature that a decision to buy or sell could not be reached by either of the parties without thorough study.

Chandler, 44 Wn.2d at 403. The sophistication of the parties and the thought that went into the contract was plainly an important factor in our one decision on alternative contracts.

The contract at issue here is of an entirely different character. It was written by Clearwire's attorneys and presented as a click-through contract on line. I urge the members of this court to consider the last time they clicked "I agree" on a software update. This is a similar contract of adhesion to which all users must agree.

Finally, the case law from other jurisdictions supports the claim that the ETFs are liquidated damages. *Mau* is a case nearly indistinguishable from this one, except that the contract was not a click-through on line contract. *Mau*, 749 F. Supp. 2d at 847. There, the court held a termination fee in a gym contract was not an alternative performance provision. *Id.* at 849. Its reasoning makes such sense in light of this case that it is worth quoting extensively:

> Fundamentally an alternative-performance analysis is conducted in response to the suggestion of an "attempt to disguise a provision for a penalty that purports to make payment of the amount an alternative performance under the contract" (Restatement (Second) of Contracts § 356 cmt. c (1981) (hereafter cited simply "cmt. c")). As *River E.* [*Plaza, LLC v. Variable Annuity Life Ins. Co.*], 498 F.3d [718,] at 722 [(7th Cir. 2007)], quoting cmt. c, says:
>
>> [A] court will look to the substance of the agreement to determine whether . . . the parties have attempted to disguise a provision for a penalty that is unenforceable. . . . In determining whether a contract is one for alternative performances, the relative value of the

> alternatives may be decisive.
>
> Of course "the underlying question is whether [a] clause is punitive in nature" (*id.*). Courts should expect to find non-punitive forms of alternative performance clauses, as opposed to traditional liquidated damage clauses, where "the 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" (24 Williston on Contracts § 65:7 (Richard Lord, ed., 4th ed. 2010)).
>
> This exposition of the alternative-performance analysis makes clear that such an analysis is not really applicable here. First, by definition there was and is no expectation of a continuing relationship between Mau and Fitness—exactly the opposite is true. Mau simply wanted to end his contract with Fitness and presumably find another place to work out, if he chooses to continue to do so.
>
> Surely the situation can more fairly be classified as nonperformance (indeed, nonperformance by Fitness rather than by Mau, when his version is credited as it must be on the current motion), rather than alternative performance.

Id. at 848-49 (some alterations in original). Here, assuming the facts most favorable to the parties appealing from the grant of a motion to dismiss, the situation is nearly identical, right down to the nonperformance being on the part of Clearwire rather than the appellants.[3]

In *In re Cellphone Termination Fee Cases*, 193 Cal. App. 4th 298, 122 Cal. Rptr. 3d 726, *cert. denied,* 132 S. Ct. 555 (2011), the California Court of Appeals held that ETFs imposed by Sprint were not alternative performance provisions. It

[3] This issue is lurking in the background of this case. The reason given by the customers-cum-plaintiffs in this case for canceling their contract with Clearwire is unreliable service. Opening Br. of Appellant at 15-19. They allege that when they tried to cancel their service because of its low quality–because of Clearwire's breach, in other words–they were charged an ETF for the privilege of canceling. *Id.*

stated that Sprint adopted ETFs after studying "the concept of term contracts with ETFs as a means to reduce its [rate of customers discontinuing service], and tested use of ETFs in selected markets." *Id.* at 306.[4] The case had a different procedural posture than this one because the trial court had already held the ETFs were not an alternative performance provision and that finding was challenged on appeal. *Id.* at 329. It also had a somewhat different factual posture because Sprint had imposed the fees mostly as a response to actual breaches by customers. *Id.* at 328. Nevertheless, the court cited favorably the trial court's observations that "the ETF provisions 'did not give the customers a rational choice of paying the ETF or completing the contract,' because the language of the ETF provision permitted Sprint to impose the fee on customers involuntarily." *Id.* (quoting the trial court).

The undisputed language in Clearwire's contracts permits Clearwire to impose the fee involuntarily. Just like Clearwire, Sprint argued that the value of the two options was relatively equal:

> Sprint argues that the trial court erred in judging the economic function of the ETF and choice it provided customers after the contract had either been performed or breached, and that it should instead have judged the choice the ETF provided customers at the outset of the contract. (*Blank v. Borden* (1974) 11 Cal.3d 963, 971, 115 Cal.Rptr. 31, 524 P.2d 127 [(1974)] [arrangement viewed from the time of making the contract]). But, as Plaintiffs respond*, the service agreements provided from the inception of the contract that an ETF could be triggered involuntarily by Sprint, confirming that at the time of contracting the provision was not understood or intended as providing only for a "rational choice" of the customer*.

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[4] We do not have a similar record indicating Clearwire's intent in this case. It is possible that its motives for imposing an ETF were entirely different from Sprint's.

Id. at 329 (emphasis added). Clearwire's contracts at the time of contracting also provided that Clearwire could unilaterally impose the ETF. It is no more plausible in this case that Clearwire's ETFs were understood as or intended to provide only for a rational choice.

CONCLUSION

Clearwire's contracts of adhesion are completely dissimilar to the carefully and fully negotiated contract wherein we found an alternative performance provision over half a century ago. The fundamental question is whether the ETFs at issue here are intended by the parties to be a true alternative or a device to make it less likely a customer will terminate monthly payments. Under the law as it now stands, these ETFs are much more like liquidated damages than alternative performances. But even if it were a closer call, we should notice the facts that Clearwire unilaterally wrote the contract and that Clearwire may unilaterally impose the ETF under the terms of the contract. We may also safely assume Clearwire wants paying customers, not cancellations. If Clearwire wants a liquidated damages clause it is welcome to include one. But that clause cannot impose an illegal penalty, and Clearwire should not be allowed to circumvent the protections a penalty analysis bestows on its customers. Because I would hold the ETFs at issue here are liquidated damages provisions subject to a penalty analysis, I dissent.

AUTHOR:
Justice Tom Chambers

WE CONCUR:

Justice Charles W. Johnson	Justice Debra L. Stephens
	Justice Charles K. Wiggins