BRAGG v. LINDEN RESEARCH, INC.

United States District Court for the Eastern District of Pennsylvania
487 F. Supp. 2d 593 (E.D. Pa. 2007)

EDUARDO C. ROBRENO, District Judge.

This case is about virtual property maintained on a virtual world on the Internet. Plaintiff, March Bragg, Esq., claims an ownership interest in such virtual property. Bragg contends that Defendants, the operators of the virtual world, unlawfully confiscated his virtual property and denied him access to their virtual world. Ultimately at issue in this case are the novel questions of what rights and obligations grow out of the relationship between the owner and creator of a virtual world and its resident-customers. While the property and the world where it is found are "virtual," the dispute is real.

Presently before the Court [is] Defendants' * * * Motion to Compel Arbitration. For the reasons set forth below, the motion will be denied.

I. BACKGROUND

A. Second Life

The defendants in this case, Linden Research Inc. ("Linden") and its Chief Executive Officer, Philip Rosedale, operate a multiplayer role-playing game set in the virtual world known as "Second Life." Participants create avatars to represent themselves, and Second Life is populated by hundreds of thousands of avatars, whose interactions with one another are limited only by the human imagination. According to Plaintiff, many people "are now living large portions of their lives, forming friendships with others, building and acquiring virtual property, forming contracts, substantial business relationships and forming social organizations" in virtual worlds such as Second Life. Owning property in and having access to this virtual world is, moreover, apparently important to the plaintiff in this case.

B. Recognition of Property Rights

In November 2003, Linden announced that it would recognize participants' full intellectual property protection for the digital content they created or otherwise owned in Second Life. As a result, Second Life avatars may now buy, own, and sell virtual goods ranging "from cars to homes to slot machines." Most significantly for this case, avatars may purchase "virtual land," make improvements to that land, exclude other avatars from entering onto the land, rent the land, or sell the land to other avatars for a profit. Assertedly, by recognizing virtual property rights, Linden would distinguish itself from other virtual worlds available on the Internet and thus increase participation in Second Life.

Defendant Rosedale personally joined in efforts to publicize Linden's recognition of rights to virtual property. For example, in 2003, Rosedale stated in a press release made available on Second Life's website that:

Until now, any content created by users for persistent state worlds, such as Everquest® or Star Wars Galaxies™, has essentially become the property of the company developing and hosting the world. . . . We believe our new policy recognizes the fact that persistent world users are making significant contributions to building these worlds and should be able to both own the content they create and share in the value that is created. The preservation of users' property rights is a necessary step toward the emergence of genuinely real online worlds.

After this initial announcement, Rosedale continued to personally hype the ownership of virtual property on Second Life. * * *

C. Plaintiffs' Participation in Second Life

In 2005, Plaintiff Marc Bragg, Esq., signed up and paid Linden to participate in Second Life. Bragg claims that he was induced into "investing" in virtual land by representations made by Linden and Rosedale in press releases, interviews, and through the Second Life website. Bragg also paid Linden real money as "tax" on his land. By April 2006, Bragg had not only purchased numerous parcels of land in his Second Life, he had also digitally crafted "fireworks" that he was able to sell to other avatars for a profit. Bragg also acquired other virtual items from other avatars.

The dispute ultimately at issue in this case arose on April 30, 2006, when Bragg acquired a parcel of virtual land named "Taessot" for $300. Linden sent Bragg an email advising him that Taessot had been improperly purchased through an "exploit." Linden took Taessot away. It then froze Bragg's account, effectively confiscating all of the virtual property and currency that he maintained on his account with Second Life.

Bragg brought suit against Linden and Rosedale in the Court of Common Pleas of Chester County, Pennsylvania, on October 3, 2006. Linden and Rosedale removed the case to this Court and then, within a week, moved to compel arbitration.

* * *

III. MOTION TO COMPEL ARBITRATION

Defendants have also filed a motion to compel arbitration that seeks to dismiss this action and compel Bragg to submit his claims to arbitration according to the Rules of the International Chamber of Commerce ("ICC") in San Francisco.

A. Relevant Facts

Before a person is permitted to participate in Second Life, she must accept the Terms of Service of Second Life (the "TOS") by clicking a button indicating acceptance of the TOS. Bragg concedes that he clicked the "accept" button before accessing Second Life. Included in the TOS are a California choice of law provision, an arbitration provision, and forum selection clause. Specifically, located in the fourteenth line of the thirteenth paragraph under the heading "GENERAL PROVISIONS," and following provisions regarding the applicability of export and import laws to Second Life, the following language appears:

> Any dispute or claim arising out of or in connection with this Agreement or the performance, breach or termination thereof, shall be finally settled by binding arbitration in San Francisco, California under the Rules of Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with said rules. . . . Notwithstanding the foregoing, either party may apply to any court of competent jurisdiction for injunctive relief or enforcement of this arbitration provision without breach of this arbitration provision.

TOS ¶ 13.

B. Legal Standards

1. Federal law applies

The Federal Arbitration Act ("FAA") requires that the Court apply federal substantive law here because the arbitration agreement is connected to a transaction involving interstate commerce. * * * The arbitration agreement is clearly connected to interstate commerce, and the Court will apply the federal substantive law that has emerged from interpretation of the FAA.

2. The Legal Standard Under the FAA

Under the FAA, on the motion of a party, a court must stay proceedings and order the parties to arbitrate the dispute if the court finds that the parties have agreed in writing to do so. 9 U.S.C. §§ 3, 4, 6. A party seeking to compel arbitration must show (1) that a valid agreement to arbitrate exists between the parties and (2) that the specific dispute falls within the scope of the agreement.

In determining whether a valid agreement to arbitrate exists between the parties, the Third Circuit has instructed district courts to give the party opposing arbitration "the benefit of all reasonable doubts and inferences that may arise," or, in other words, to apply the familiar Federal Rule of Civil Procedure 56(c) summary judgment standard. Par-Knit Mills, Inc. v. Stockbridge Fabrics Co., Ltd., 636 F.2d 51, 54 & n. 9 (3d Cir. 1980). While there is a presumption that a particular dispute is within the scope of an arbitration agreement, there is no such "presumption" or "policy" that favors the existence of a valid agreement to arbitrate.

C. Application

1. Unconscionability of the Arbitration Agreement

Bragg resists enforcement of the TOS's arbitration provision on the basis that it is "both procedurally and substantively unconscionable and is itself evidence of defendants' scheme to deprive Plaintiff (and others) of both their money and their day in court." * * * When determining whether such defenses might apply to any purported agreement to arbitrate the dispute in question, "courts generally . . . should apply ordinary state-law principles that govern the formation of contracts." First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995). Thus, the Court will apply California state law to determine whether the arbitration provision is unconscionable.

Under California law, unconscionability has both procedural and substantive components. The procedural component can be satisfied by showing (1) oppression through the existence of unequal bargaining positions or (2) surprise through hidden terms common in the context of adhesion contracts. Comb v. PayPal, Inc., 218 F. Supp. 2d 1165, 1172 (N.D. Cal. 2002). The substantive component can be satisfied by showing overly harsh or one-sided results that "shock the conscience." Id. The two elements operate on a sliding scale such that the more significant one is, the less significant the other need be. However, a claim of unconscionability cannot be determined merely by examining the face of the contract; there must be an inquiry into the circumstances under which the contract was executed, and the contract's purpose, and effect.

(a) Procedural Unconscionability

A contract or clause is procedurally unconscionable if it is a contract of adhesion. A contract of adhesion, in turn, is a "standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Comb*, 218 F. Supp. 2d at 1172. Under California law, "the critical factor in procedural unconscionability analysis is the manner in which the contract or the disputed clause was presented and negotiated." Nagrampa v. MailCoups, Inc., 469 F.3d 1257, 1282 (9th Cir. 2006). "When the weaker party is presented the clause and told to 'take it or leave it' without the opportunity for meaningful negotiation, oppression, and therefore procedural unconscionability, are present." *Id.* (internal quotation and citation omitted).

The TOS are a contract of adhesion. Linden presents the TOS on a take-it-or-leave-it basis. A potential participant can either click "assent" to the TOS, and then gain entrance to Second Life's virtual world, or refuse assent and be denied access. Linden also clearly has superior bargaining strength over Bragg. Although Bragg is an experienced attorney, who believes he is expert enough to comment on numerous industry standards and the "rights" or participants in virtual worlds, he was never presented with an opportunity to use his experience and lawyering skills to negotiate terms different from the TOS that Linden offered.

Moreover, there was no "reasonably available market alternatives [to defeat] a claim of adhesiveness." Cf. Dean Witter Reynolds, Inc. v. Superior Court, 259 Cal. Rptr. 789, 795 (1989) (finding no procedural unconscionability because there were other financial institutions that offered competing IRA's which lacked the challenged provision). Although it is not the only virtual world on the Internet, Second Life was the first and only virtual world to specifically grant its participants property rights in virtual land.

The procedural element of unconscionability also "focuses on . . . surprise." Gutierrez v. Autowest, Inc., 7 Cal. Rptr. 3d 267, 275 (2003). In determining whether surprise exists, California courts focus not on the plaintiff's subjective reading of the contract, but rather, more objectively, on "the extent to which the supposedly agreed-upon terms of the bargain are hidden in the prolix printed form drafted by the party seeking to enforce the disputed terms." *Id.*

Here, although the TOS are ubiquitous throughout Second Life, Linden buried the TOS's arbitration provision in a lengthy paragraph under the benign heading "GENERAL PROVISIONS." See TOS ¶ 13. Linden also failed to make available the costs and rules of arbitration in the ICC by

either setting them forth in the TOS or by providing a hyper-link to another page or website where they are available.

Comb is most instructive. In that case, the plaintiffs challenged an arbitration provision that was part of an agreement to which they had assented, in circumstances similar to this case, by clicking their assent on an online application page. The defendant, PayPal, was a large company with millions of individual online customers. The plaintiffs, with one exception, were all individual customers of PayPal. Given the small amount of the average transaction with PayPal, the fact that most PayPal customers were private individuals, and that there was a "dispute as to whether PayPal's competitors offer their services without requiring customers to enter into arbitration agreements," the court concluded that the user agreement at issue "satisfie[d] the criteria for procedural unconscionability under California law." 218 F. Supp. 2d at 1172-73. Here, as in *Comb*, procedural unconscionability is satisfied.

(b) Substantive Unconscionability

Even if an agreement is procedurally unconscionable, "it may nonetheless be enforceable if the substantive terms are reasonable." *Id*. at 1173. Substantive unconscionability focuses on the one-sidedness of the contract terms. Here, a number of the TOS's elements lead the Court to conclude that Bragg has demonstrated that the TOS are substantively unconscionable.

(i) Mutuality

Under California law, substantive unconscionability has been found where an arbitration provision forces the weaker party to arbitrate claims but permits a choice of forums for the stronger party. In other words, the arbitration remedy must contain a "modicum of bilaterality." Armendariz v. Foundation Health Psychcare Servs., Inc., 6 P.3d 669, 692 (Cal. 2000). * * *

Here, the TOS contain many of the same elements that made the PayPal user agreement substantively unconscionable for lack of mutuality [in Comb v. PayPal, Inc.]. The TOS proclaim that "Linden has the right at any time for any reason or no reason to suspend or terminate your Account, terminate this Agreement, and/or refuse any and all current or future use of the Service without notice or liability to you." TOS ¶ 7.1. Whether or not a customer has breached the Agreement is "determined in Linden's sole discretion." *Id*. Linden also reserves the right to return no money at all based on mere "suspicions of fraud" or other violations of law. *Id*. Finally, the TOS state that "Linden may amend this Agreement . . . at any time in its sole discretion by posting the amended Agreement [on its website]." TOS ¶ 1.2.

In effect, the TOS provide Linden with a variety of one-sided remedies to resolve disputes, while forcing its customers to arbitrate any disputes with Linden. This is precisely what occurred here. When a dispute arose, Linden exercised its option to use self-help by freezing Bragg's account, retaining funds that Linden alone determined were subject to dispute, and then telling Bragg that he could resolve the dispute by initiating a costly arbitration process. The TOS expressly authorized Linden to engage in such unilateral conduct. As in Comb, "[f]or all practical purposes, a customer may resolve disputes only after [Linden] has had control of the disputed funds for an indefinite period of time," and may only resolve those disputes by initiating arbitration. 218 F. Supp. 2d at 1175.

Linden's right to modify the arbitration clause is also significant. "The effect of [Linden's] unilateral right to modify the arbitration clause is that it could . . . craft precisely the sort of asymmetrical arbitration agreement that is prohibited under California law as unconscionable." Net Global Mktg., Inc. v. Dialtone, Inc., 217 Fed. Appx. 598, 602 (9th Cir. 2007). This lack of mutuality supports a finding of substantive unconscionability.

(ii) Costs of Arbitration and Fee-Sharing

* * * [T]he Court estimates the costs of arbitration with the ICC to be $17,250 * * *, although they could reach as high as $27,375 * * *. These costs might not, on their own, support a finding of substantive unconscionability. However, the ICC Rules also provide that the costs and fees must be shared among the parties, and an estimate of those costs and fees must be advanced at the initiation of arbitration. California law has often been applied to declare arbitration fee-sharing schemes unenforceable. See Ting v. AT&T, 319 F.3d 1126, 1151 (9th Cir. 2003). Such schemes are unconscionable where they "impose[] on some consumers costs greater than those a complainant would bear if he or she would file the same complaint in court." *Id*. In *Ting*, for example, the Ninth Circuit held that a scheme requiring AT & T customers to split arbitration costs with AT & T rendered an arbitration provision unconscionable. *Id.*

Here, even taking Defendants' characterization of the fees to be accurate, the total estimate of costs and fees would be $7,500, which would result in Bragg having to advance $3,750 at the outset of arbitration. The court's own estimates place the amount that Bragg would likely have to advance at $8,625, but they could reach as high as $13,687.50. Any of these figures are significantly greater than the costs that Bragg bears by filing his action in a state or federal court. Accordingly, the arbitration costs and fee-splitting scheme together also support a finding of unconscionability.

(iii) Venue

The TOS also require that any arbitration take place in San Francisco, California. In *Comb*, the Court found that a similar forum selection clause supported a finding of substantive unconscionability, because the place in which arbitration was to occur was unreasonable, taking into account "the respective circumstances of the parties." 218 F. Supp. 2d at 1177. As in *Comb*, the record in this case shows that Linden serves millions of customers across the United States and that the average transaction through or with Second Life involves a relatively small amount. See *id*. In such circumstances, California law dictates that it is not "reasonable for individual consumers from throughout the country to travel to one locale to arbitrate claims involving such minimal sums." *Id.* Indeed, "[l]imiting venue to [Linden's] backyard appears to be yet one more means by which the arbitration clause serves to shield [Linden] from liability instead of providing a neutral forum in which to arbitrate disputes." *Id*.

(iv) Confidentiality Provision

Arbitration before the ICC, pursuant to the TOS, must be kept confidential pursuant to the ICC rules. Applying California law to an arbitration provision, the Ninth Circuit held that such confidentiality supports a finding that an arbitration clause was substantively unconscionable. *Ting*, 319 F.3d at 1152. The Ninth Circuit reasoned that if the company succeeds in imposing a gag order

on arbitration proceedings, it places itself in a far superior legal posture by ensuring that none of its potential opponents have access to precedent while, at the same time, the company accumulates a wealth of knowledge on how to negotiate the terms of its own unilaterally crafted contract. The unavailability of arbitral decisions could also prevent potential plaintiffs from obtaining the information needed to build a case of intentional misconduct against a company. See *id.*

This does not mean that confidentiality provisions in an arbitration scheme or agreement are, in every instance, per se unconscionable under California law. Here, however, taken together with other provisions of the TOS, the confidentiality provision gives rise for concern of the conscionability of the arbitration clause.

Thus, the confidentiality of the arbitration scheme that Linden imposed also supports a finding that the arbitration clause is unconscionable.

* * *

(c) Conclusion

When a dispute arises in Second Life, Linden is not obligated to initiate arbitration. Rather, the TOS expressly allow Linden, at its "sole discretion" and based on mere "suspicion," to unilaterally freeze a participant's account, refuse access to the virtual and real currency contained within that account, and then confiscate the participant's virtual property and real estate. A participant wishing to resolve any dispute, on the other hand, after having forfeited its interest in Second Life, must then initiate arbitration in Linden's place of business. To initiate arbitration involves advancing fees to pay for no less than three arbitrators at a cost far greater than would be involved in litigating in the state or federal court system. Moreover, under these circumstances, the confidentiality of the proceedings helps ensure that arbitration itself is fought on an uneven field by ensuring that, through the accumulation of experience, Linden becomes an expert in litigating the terms of the TOS, while plaintiffs remain novices without the benefit of learning from past precedent.

Taken together, the lack of mutuality, the costs of arbitration, the forum selection clause, and the confidentiality provision that Linden unilaterally imposes through the TOS demonstrate that the arbitration clause is not designed to provide Second Life participants an effective means of resolving disputes with Linden. Rather, it is a one-sided means which tilts unfairly, in almost all situations, in Linden's favor. As in Comb, through the use of an arbitration clause, Linden "appears to be attempting to insulate itself contractually from any meaningful challenge to its alleged practices." 218 F. Supp. 2d at 1176. * * *

Finding that the arbitration clause is procedurally and substantively unconscionable, the Court will refuse to enforce it.