'Agree' To Disagree: SDNY Examines the Limits of Terms of Service Agreements

by Steve Kramarsky

We've all done it: checked the box and confirmed that we are bound by a company's "Terms of Service" without so much as glancing at them. These days, "Agree to Continue" is a part of the required ritual, not only for software and online services, but for hardware as well. Before you use your new iPhone, draft a Word document, call an Uber, or even order a pizza, you will have agreed, sight unseen, to a set of standardized terms drafted by a company's lawyers. For most people, the choice is simple. Most users do not have the time or inclination to read through dozens of pages of legalese before reviewing the morning's tweets, and if millions of users are agreeing to these terms, how bad can they be? If a company's Terms of Service become too onerous, or stray too far from accepted industry norms, the company will likely be called out by a sophisticated user or industry watchdog.

This system has functioned with surprising efficiency during a period of explosive growth, and at this point nearly all e-commerce depends on users agreements to contracts virtually no one has ever read. Courts are well aware of that dynamic, and many have commented on it, but have largely upheld these kinds of agreements based on traditional contract law principles. The "click" of agreement, or the ongoing use of the product or service, functions as the user's agreement to the Terms of Service, regardless of whether the user knows precisely what the Terms say. Contracting parties are assumed to have reviewed and agreed to all terms of their agreement.

One result of this setup is that the legal framework governing the relationship between the consumer and the company is not necessarily what the consumer would expect it to be. Many of the laws that might otherwise govern that relationship are replaced by the Terms of Service. For example, many Terms of Service agreements include arbitration clauses and prohibitions on class or collective actions. Users who might otherwise have a legal right to be a part of a class action in court must give up that right if they want to use those products or services. In some ways (knowingly or unknowingly) they are agreeing to give up some of the protection than the law would otherwise provide, because the company demands that concession in exchange for the use of its product.

For the most part, courts have been willing to enforce that bargain—certainly in areas such as arbitration and collective action. But at a certain point, the state has an interest in protecting its citizens that has some value of its own. Can companies override statutory schemes by contract? Can they disclaim liability for fraudulent marketing practices through corrective disclosure in their Terms of Service? Or is some stricter standard to be applied? To a great extent, the answer may depend on the statutory scheme under

which the claim is brought. *Fishon v. Peloton Interactive*, a recent decision out of the Southern District of New York, took up those questions and is worth a closer look. 2020 WL 5654755 (S.D.N.Y. Nov. 9, 2020).

Background

Peloton is a now-familiar company that sells home exercise equipment, including stationary bicycles and treadmills, through which their users can stream on-demand fitness class videos. Those classes are taught by instructors who provide guidance and encouragement over a background beat of curated musical tracks. To participate, users must purchase both the stationary equipment and a monthly membership that provides access to Pelton's content library.

One major thrust of Pelton's brand marketing is the number, variety, and quality of the classes offered through its content library. In 2018 and 2019, Peloton described the classes in its library as "ever-growing." However, in March 2019, in response to a lawsuit alleging Peloton had used copyrighted music in its classes without the proper licensing, Peloton removed nearly 57% of the available classes from its library.

'Fishon'

On Dec. 20, 2019, Eric Fishon and Alicia Pearlman filed a putative class action on behalf of themselves and other purchasers of Peloton equipment alleging that Peloton's advertisements regarding their "ever-growing" library were false and misleading and wrongfully induced purchases of Peloton equipment at inflated prices. Plaintiffs alleged that they purchased Pelton equipment "in reliance on the promise" that the library would continue to grow as advertised. As a result of the reduction in classes (and corresponding reduction in available music), plaintiffs alleged that the quality and associated value of the user experience was materially diminished and they "never would have purchased a Pelton bike or subscription on the same terms" if "they had known the truth." Plaintiffs further alleged that Peloton knew its marketing was deceptive because it was aware that it was improperly using copyrighted material and the reduction in number of classes was therefore inevitable. *Fishon*, 2020 WL 5654755, at *1.

Plaintiffs brought suit under §§349 and 350 of the New York General Business Law (GBL), which prohibit deceptive acts and practices as well as false advertising. Those sections were enacted "to prevent deceptive and misleading acts, practices and advertising in the State of New York." Id. at *2. To state a claim a plaintiff must allege (1) that the defendant's acts were consumer oriented, (2) that the acts or practices are deceptive or misleading in a material way, and (3) that the plaintiff has been injured as a result. Id. Peloton moved to dismiss the claims on six grounds, including that the GBL claims were barred because Peloton disclaimed the allegedly misleading advertising in its Terms of Service and that the non-New-York plaintiff (Ms. Pearlman) did not have standing under the GBL to pursue her claim.

First, the court considered Peloton's argument that it was insulated from liability for its alleged misleading

advertising because it disclosed in its Terms of Service (to which the plaintiffs all necessarily agreed to be bound), that Peloton reserved the right to modify its class library at will. Peloton argued that because each plaintiff agreed to be bound by that provision, Peloton could not be held liable for any false or misleading business practice regarding the modification of the library. Judge Liman rejected that argument observing that "Peloton's Terms of Service may have protected it from a breach of contract or similar claim" but they "do not relieve Peloton from a deceptive marketing claim based on the allegation that Peloton advertised its library as ever-growing while knowing that it would be diminishing or shrinking in size." *Fishon*, 2020 WL 5654755, at *3.

Following Second Circuit precedent, the court based its findings on two operative legal principles: whether the allegedly clarifying disclosure adequately dispels the false inference created by the advertising and whether the clarifying disclosure was sufficiently prominent such that a reasonable consumer would have noticed it. As to the first question, the court found that the disclosure in the Terms of Service merely informed users they could not expect any particular class or group of classes to remain on the platform. It did not, however, speak to the total size of the collection and therefore did not directly address the allegedly false statement that the number of classes was "ever-growing." Id. at *4.

More fundamentally, the court considered whether a clarifying disclosure buried in a Terms of Service could put a reasonable consumer on notice that the information prominently displayed in Peloton's advertising was inaccurate or subject to change. The court considered the relative prominence of the two statements and concluded that a reasonable consumer could not be charged with reviewing the fine print to correct a focal point of Peloton's marketing. Id. (quoting *Williams v. Gerber Prods. Co.*, 552 F.3d 934, 939 (2d Cir. 2008) (a reasonable consumer "should [not] be expected to look beyond misleading representations on the front of the box to discover the truth from the ingredient list in small print on the side of the box.").

Peloton's Terms of Service "were not part of the advertisement" and, in the court's judgment, [a] reasonable consumer, having viewed Peloton's advertisements on its website and having decided to purchase a Peloton product based on the understanding the library would grow" should not be expected to review the Terms of Service to determine whether that advertising was false. The court noted its conclusion was based in part on its understanding of the purpose of the regulatory regime, to permit individual consumers (even without a showing of injury) to pursue claims for allegedly misleading business practices.

Second, Peloton argued that one plaintiff, a Michigan resident, did not have standing to sue under the GBL, despite Peloton's principal place of business in New York and the Terms of Service providing for application of New York law. The GBL only applies to transactions occurring "in [New York] state," so the court had to determine where the allegedly deceptive transaction involving the out-of-state defendant took place.

Importantly, the court noted that question did not turn merely on residency of the parties, it was rather

a question of where the alleged transaction took place. Therefore, in a case where "Florida residents were misled by misrepresentations conveyed to them by a New York-domiciled corporation based on a misleading advertising campaign hatched in New York," the Florida plaintiffs nonetheless lacked standing to pursue a GBL claim because they "received the misleading information in Florida, made their purchases in Florida, and paid a premium in Florida." *Fishon*, 2020 WL 5654755, at *12 (citing *Goshen v. Mutual Life Ins. Co.*, 774 N.E.2d 1190, 1194 (N.Y. 2002)). So too in this case, the court reasoned, the out-of-state plaintiff, without allegations to the contrary (such as that she had traveled to New York to purchase the equipment), lacked standing to pursue her claim based on an inference that any transaction took place in Michigan, rather than New York. The court found New York choice of law and venue provisions in the Terms of Service did not alter the result—the question is where the transaction took place, not what law governs.

Continuing Analysis

The *Fishon* case touched on two crucial questions in many technology-assisted transactions: where did the transaction take place, and to what extent can users be bound by agreements they may never have read?

As to the former question, Fishon was a relatively straightforward legal analysis. There were no allegations regarding the out-of-state plaintiff's location when reviewing Peloton's marketing materials and purchasing her equipment. Based on the lack of any concrete allegations, the court was able to side-step potentially difficult questions about "where" the purchase took place. Notably, however, the mere fact that the allegedly deceptive practice came from a New York-based company, or that the Terms of Service selected New York laws and venue, was not sufficient to permit an action under the New York consumer protection law.

As to the latter, the court had to conduct a detailed, and complex, analysis. Unlike the standard contractual analysis, where plaintiffs are assumed to have extensively reviewed the terms to which they are purported to have agreed, the court considered the purpose of the statutory provision and whether a reasonable consumer should be required to sort through the Terms of Service to "make sure" that they do not contain some statement that contradicts or "corrects" the company's advertising. Based on the court's understanding of the statutory purpose, it found consumers should not be held to such a high standard.

Companies have long argued that the use of Terms of Service to govern the customer relationship (and in some cases to replace existing background laws) gives them the protection and flexibility they need to offer innovative products and services. But some legal frameworks embody policy concerns or public goods that may be in tension with those efficiencies. The court in *Fishon* held, broadly speaking, that New York's consumer protection law cannot be contracted around—at least not by a general statement

in the Terms of Service. It will be worth keeping an eye out to see whether that conclusion extends into other areas of the law.

This article first appeared in the *New York Law Journal* on January 25, 2020. Stephen M. Kramarsky, a member of Dewey Pegno & Kramarsky, focuses on complex commercial and intellectual property litigation. Jack Millson, an associate at the firm, provided substantial assistance with the preparation of this article.