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NJ Pushes Back Against Pro-Arbitration Federal Policy

Law360, New York (March 10, 2015, 11:43 AM ET) --

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Over the past several months, New Jersey courts and the New Jersey Legislature have taken steps to limit the impact of recent U.S. Supreme Court cases endorsing the use of arbitration clauses to limit exposure to consumer fraud class actions. Because arbitration provisions appear in many routine consumer contracts and often include class action waivers, the net effect of this trend is to make New Jersey a more attractive venue for the filing of such class actions.

Recent Supreme Court Precedent on Consumer Arbitration

In a series of recent cases including AT&T Mobility LLC v. Concepcion and American Express Co. v. Italian Colors Restaurant, the Supreme Court held that the Federal Arbitration Act's strong national policy in favor of arbitration is expansive enough to require the enforcement of contractual arbitration agreements that effectively prohibit consumers from bringing claims as class actions.

In Concepcion, the plaintiffs entered into a mobile phone contract and, upon receiving a bill for sales tax on a phone advertised as free, brought an action for consumer fraud in court against their service provider. The contract mandated the arbitration of all disputes and required that such arbitration be brought in the consumer's "individual capacity" and not as part of a class. The California Supreme Court found the arbitration provision unconscionable, reasoning that courts should not enforce contracts of adhesion when they operate to preclude class actions in matters with predictably small amounts of damages, as the effect of such enforcement is to insulate the defendant from liability. The Supreme Court reversed and held the agreement enforceable, finding that California's arbitration-specific rule of unconscionability interfered with the federal policy in favor of arbitration and was therefore preempted by the Federal Arbitration Act.

An important limitation, however, is that the Federal Arbitration Act will not require enforcement of arbitration agreements unless the consumer's consent to arbitrate is established under generally applicable state law contract principles. See 9 U.S.C. Section 2. This caveat provides an opening for state courts and legislatures to set high bars for establishing consumer consent, in order to limit the sweep of Concepcion and Italian Colors — and New Jersey is now doing exactly that.

New Jersey's Recent Jurisprudence on Consumer Consent to Arbitrate

In Atalese v. U.S. Legal Services Group LP, the plaintiff entered into a contract containing a standard-form arbitration provision which stated that any dispute between the parties "shall be submitted to binding arbitration upon the request of either party." While most attorneys would think that the word "arbitration" is clear, the New Jersey Supreme Court held the clause unenforceable because it did not explain to the consumer that "arbitration" meant that she waived her right to sue in court and have a jury decide her New Jersey Consumer Fraud Act claim. The New Jersey Supreme Court found that the absence of that kind of detailed, consumer-friendly explanation meant that the consumer had not knowingly consented to arbitrate her disputes, thereby rendering the entire arbitration clause unenforceable as a matter of state contract law.

Because many standard-form arbitration clauses do not contain these kinds of "magic words" now required by the New Jersey Supreme Court, the Atalese decision has sharply limited the enforceability of many arbitration clauses in the Garden State.

For example, in Dispenziere v. Kushner Companies, New Jersey's Appellate Division held that the Atalese rule also applies to common law causes of action and even when the party was represented by counsel when he or she entered into the arbitration clause. Indeed, out of five appellate division and federal district court decisions applying Atalese, only one has found the arbitration clause in question sufficiently clear to require arbitration.

On Jan. 21, 2015, the defendant in Atalese filed a petition for a writ of certiorari with the Supreme Court, arguing that the decision runs afoul of the strong federal preference favoring arbitration of disputes. The petition has garnered interest from amici, including the U.S. Chamber of Commerce, New Jersey Civil Justice Institute andPacific Legal Foundation. If the Supreme Court does not grant the petition, then the standard for enforcing arbitration clauses in New Jersey will remain substantially higher than it is in most other jurisdictions, and companies seeking to bind New Jersey customers to arbitration will have to remain cognizant of these important limitations.

The New Jersey Supreme Court will soon be revisiting the issue of arbitration clauses and the scope of their enforceability. In Morgan v. Sanford Brown Institute, the appellate division rejected an unconscionability argument and enforced a contractual arbitration provision. The court noted that although the arbitration provision impermissibly limited statutory remedies under the New Jersey Consumer Fraud Act by waiving treble damages and attorney's fee awards, the contract's severability clause meant that any such claims could still be arbitrated, subject to an arbitrator's ability to sever the limitations of remedy if they deemed unlawful. The New Jersey Supreme Court recently granted the plaintiffs' petition for certification, "limited to the issue of whether plaintiffs can be compelled to arbitrate all claims related to their enrollment agreements, including their Consumer Fraud Act claims, under the terms of this arbitration agreement." Morgan v. Sanford Brown Institute, 220 N.J. 265 (2015). Thus, in the coming months, the court will once again have the opportunity to limit the impact of arbitration clauses on consumer fraud class actions.

Proposed Legislation in the New Jersey Legislature

In addition to the New Jersey Supreme Court's new jurisprudence in this area, the New Jersey Legislature has also joined the fray and is poised to push back further against the enforceability of arbitration clauses. In February 2015, the New Jersey Assembly Consumer Affairs Committee passed A-4097, which would overhaul New Jersey's Truth-in-Consumer Contract, Warranty and Notice Act.

If enacted, A-4097 would prevent any consumer contract from including terms that waive certain consumer rights, including the right to have New Jersey "serve as the forum, jurisdiction or venue for the resolution of any dispute," the right to bring a class action, the right to discovery pursuant to New Jersey's Rules of Court and the right to a jury trial absent a waiver signed by the consumer's attorney. Although this legislation does not explicitly address arbitration, at a recent hearing several members of the New Jersey Assembly indicated that one of the legislation's goals is to curb the ubiquitous use of arbitration agreements in consumer contracts.

The consequences of this legislation extend beyond the mere enforceability of arbitration provisions. When a consumer demonstrates a violation of TCCWNA in a consumer contract, he or she is automatically entitled to a $100 civil penalty and attorney's fees for bringing the claim. When TCCWNA claims are aggregated into class actions, businesses may face large claims brought on behalf of all their customers with contracts containing violative provisions. If A-4097 is enacted, businesses including arbitration provisions in their consumer contracts could be exposed to substantial civil penalties, even if they never attempt to enforce the arbitration provisions that violate the new TCCWNA restrictions.

Of course, A-4097 as presently drafted would be vulnerable to a constitutional challenge on the grounds that it is preempted by the Federal Arbitration Act. But until such a challenge is successfully mounted, businesses would need to tread carefully when dealing with New Jersey customers, as the mere inclusion of arbitration provisions could result in exposure to liability.

Conclusion

Clearly, both the New Jersey Supreme Court and New Jersey Legislature are moving to limit a company's ability to insulate itself against class actions through use of an arbitration clause. Businesses operating in the Garden State should remain alert to these developments, as the state courts and legislature continue to seek means to weaken the Supreme Court's recent pro-arbitration jurisprudence.

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