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Arbitration Is Under Attack: Counsel Should Pay Attention

By Timothy F. Hegarty

While not the sexiest topic in the construction world, transactional attorneys and litigators in New Jersey should be aware of recent case law and media attacks regarding arbitration. Recent divergent opinions from the United States Supreme Court and the New Jersey Supreme Court are proving difficult to reconcile, regarding the enforceability of agreements to arbitrate disputes.

At the heart of the debate is the U.S. Supreme Court's application of the Federal Arbitration Act (FAA), 9 U.S.C.A. §§1–16, to preempt efforts by state laws and their courts that undermine the goals and policies of the FAA. Indeed, the New Jersey Supreme Court has taken a hard-line position: contracts must expressly state that the parties are aware that in electing arbitration as the exclusive remedy, they clearly and unambiguously waive their Constitutional right to sue. If the contract is not clear and unambiguous, New Jersey courts will reject efforts to compel arbitration.

Arbitration Basics

Arbitration is a widely used alternative dispute resolution (ADR) process in which the dispute(s) is submitted to one or more neutral persons for a final and binding decision. Although it is an alternative to traditional litigation, arbitration shares some similarities to litigation. First, like the traditional "complaint" and "answer," the parties prepare pleadings including a "demand" and a "response." Second, arbitrators typically hold pre-arbitration hearings to review disputed issues and set a hearing schedule. Third, hearings are held where the parties present evidence, including expert opinion and argue the merits of their respective positions. Fourth, arbitrators render a decision in the form of an award. Absent fraud or the like, awards in arbitration are treated like judgments entered by a court.

When many think of the perceived benefits of arbitration, they often think about cost savings. While arbitration can certainly be cost-effective, proponents also argue that it provides privacy/confidentiality, an efficient and prompt resolution with sophisticated decision-makers selected by the parties, greater flexibility in terms of scheduling and finality of the dispute.

On the flip side, arbitration critics cite to the perceived disadvantages. First, limited discovery is typically permitted in arbitration. Second, since the proceedings are more informal, the Rules of Evidence generally do not apply. Third, the availability of motion practice is much more limited. Finally, absent fraud, corruption, arbitrator misconduct or the like, the parties cannot appeal the decision if they disagree with the award.

New York Times Critique of Arbitration

Late last fall, the *New York Times* published a highly critical series of articles focusing on the use of mandatory arbitration clauses. In their three-part series, "Beware the Fine Print," the *New York Times* explored the history of mandatory arbitration clauses and asserted that corporations routinely use these clauses to protect themselves from wrongful conduct by denying individuals their constitutional right to have their day in court. The *Times* asserts that businesses are using arbitration clauses to "create an alternate system of justice."

In Part I, the history of arbitration agreements and how they became widespread in various consumer contracts, such as credit cards, cell phones, cable television as well as employment contracts, is explained. The *Times* reported that major corporations eventually included class action bans as part of these agreements which were upheld by the U.S. Supreme Court. According to the *Times*, as a result of this resounding success, arbitration clauses are now routinely found in medical practices, private schools and funeral homes.

In Part II, the *Times* explained that due to the overwhelming success of major corporations, the use of arbitration clauses spread to small business. The *Times* cited specific examples of losing cases involving claims of sexual discrimination and nursing home neglect. The primary target in the piece was the arbitrators themselves, because arbitration favors businesses and arbitrators, who are paid by the parties, are economically incentivized to rule in favor of the side who is likely to provide them with repeat business. The

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Times also lamented that the "secretive nature of the process makes it difficult to ascertain how fairly the proceedings are conducted."

In Part III, the *Times* reported that some businesses even require that disputes including secular problems such as claims of financial fraud and wrongful death be arbitrated by religious tribunals, applying Biblical or other religious principles, rather than state or federal law. The *Times* reports that these particular clauses "have often proved impervious to legal challenges" because few courts have intervened and speculated that one of reasons is concern regarding First Amendment rights of the religious groups.

Case Law and Federal Pre-emption

Coincidentally, shortly after the *New York Times* series ran, the U.S. Supreme Court issued its decision in *DirectTV v. Imburgia*, 577 U.S. __, No. 14-462, slip op. at 1 (Dec. 14, 2015), in which the court upheld a binding arbitration clause in a consumer service agreement that included a waiver of class arbitration. The decision was a strongly worded reaffirmation of the court's view of the supremacy of the FAA and its application even in contracts nominally governed by state law. Justice Breyer wrote for the six-member majority overturning the lower California court for undermining an agreement to arbitrate, primarily because the court was skeptical that the California court interpreted the arbitration contract as it would any other contract. Indeed, in the past, the Supreme Court similarly applied the FAA to pre-empt state laws that impose special conditions on the enforceability of agreements to arbitrate.

For example, in *Doctor's Associates v. Casarotto*, the Supreme Court held that the FAA pre-empted a Montana law requiring arbitration clauses to be (a) typed in capital letters, (b) underlined, and (c) appear on the first page of the contract. 517 U.S. 681, 686-89 (1996). Accordingly, the *Imburgia* ruling does not break new ground, but its admonition should serve as notice that efforts by lower courts to circumvent arbitration agreements will not be tolerated.

New Jersey Case Law

As a preliminary issue, in addition to the FAA, New Jersey has a nearly identical Arbitration Act, N.J.S.A. 2A:23B–1 to –32. While there have been a plethora of these cases, the most recent authoritative case in New Jersey on this issue is *Atalese v. U.S. Legal Services Group*, 219 N.J. 430 (2014), *cert. denied* June 8, 2015. *Atalese* involved an arbitration provision in a consumer contract with a debt-adjustment service. The New Jersey Supreme Court acknowledged that the FAA places arbitration agreements on equal footing with all other contracts, and was careful to recognize federal and state policies

favoring arbitration citing Hojnowski v. Vans Skate Park, 187 N.J. 323, 342 (2006) (noting that the legislature, in enacting New Jersey's Arbitration Act, codified existing judicial policy favoring arbitration as "means of dispute resolution"). *Atalese*, at 440.

However, the court refused to enforce the arbitration clause because the court did not find contract language evidencing mutual assent to have the claims decided by arbitration in lieu of going to court. The provision did not explain that "arbitration" meant that "plaintiff was waiving her right to seek relief in court." *Id*. at 447.The court held that an arbitration provision must provide reasonable notice that arbitration is the parties' sole remedy and specifically state that the parties waived their right to sue in court. Perhaps anticipating the reaction from the U.S. Supreme Court, the court went to great lengths to reiterate that its decision was not inconsistent with the FAA, concluding, "[t]o be clear, under our state contract law, we impose no greater burden on an arbitration agreement than on any other agreement waiving constitutional or statutory rights." *Id*.

In *Dispenziere v. Kushner Cos.*, the Appellate Division held that an arbitration provision in a real estate contract was unenforceable because it did not expressly include the express notice that the parties were waiving their right to sue in court. 101 A. 3d 1126 (N.J. Sup. Ct. App. Div. 2014). Interestingly, some of the plaintiffs in *Dispenziere* were represented by counsel in their real estate transactions. In relying upon *Marchak v. Claridge Commons,* 134 N.J. 275, 282-83 (1993), however, the court dismissed this argument holding that the "real problem is not inequality of bargaining power between the parties. Rather, it is something more fundamental: the agreement simply does not state that the buyer elects arbitration as the sole remedy." *Id.* at 1132. While not tying the reasoning to mutual assent, the court found that the arbitration provision is "devoid of any language that would inform unit buyers such as plaintiffs that they were waiving their right to seek relief in a court of law. Following *Atalese,* we deem this lack of notice fatal to defendants' efforts to compel plaintiffs to arbitrate their claims." *Id*. at 1131.

Unfortunately, the U.S. Supreme Court denied the petition for certiori and will not hear the appeal in *Atalese*, which means *Atalese* stands as the controlling law in New Jersey. In the meantime, while the *Atalese* court stopped short of requiring magic words to ensure that an arbitration provision would pass muster, it did provide several examples of arbitration clauses that it would find to be enforceable including this one from Curtis v. Cellco Partnership, 413 N.J. Super. 26, 33-37 (App. Div.) *certif. denied*, 203 N.J. 94 (2010).

Instead of suing in court, we each agree to settle disputes (except certain small claims) only by arbitration. The rules in arbitration are different. There's no judge or jury, and review is limited, but an arbitrator can award the same damages and relief, and must honor the same limitations stated in the agreement as a court would.

Id. at 445. Alternatively, the court cited this shorter one from Griffin v. Burlington Volkswagen, 411 N.J. Super. 515, 518 (App. Div. 2010): "By agreeing to arbitration, the parties understand and agree that they are waiving their rights to maintain other available resolution processes, such as a court action or administrative proceeding, to settle their disputes."

Reaction to these court cases and media attention has been swift and have led some to urge the arbitration community to address the criticisms and consider changes. Some ideas include regulating arbitration organizations, requiring certification/licensing of arbitrators, and making public certain non-proprietary information about arbitration awards and arbitrators' past performance. Subject to further guidance from the courts or the legislature, both transactional attorneys and litigators should heed the advice from the *Atalese* court and exercise due care when crafting arbitration agreements to avoid ambiguous or conflicting language that could be seized upon by an adversary to challenge the scope or enforceability of the agreement to arbitrate disputes. ■

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