

CLIENT ALERT



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NJ's Judicial Hostility to Arbitration Means Businesses Need to Adapt

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Recently, when students of Rutgers' arbitration law class were asked whether the New Jersey Supreme Court's decision in *Atalese v. United States Legal Services Group*, which struck an arbitration clause in a consumer agreement for failing to give a consumer proper notice she was waiving her right to court, would survive U.S. Supreme Court scrutiny, there was consensus: there was a good chance it would not. The class thought that the

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decision may represent the kind of state court judicial hostility toward arbitration that the U.S. Supreme Court sought to stamp out under its Federal Arbitration Act (FAA) precedent. It looks like others may agree, as the opinion has been petitioned for U.S. Supreme Court review and several amici curiae have joined in support.

Yet, unless the court grants the petition and overturns the decision, *Atalese* will remain the law in New Jersey. Indeed, in just the few months since it was decided, several New Jersey lower courts have followed *Atalese* and struck down other arbitration clauses because the clauses lacked explicit waiver-of-rights language. The stakes here are high—many businesses use arbitration clauses to protect themselves from class-action liability through class-action waivers in the clauses. In order to continue that protection, and regardless of any U.S. Supreme Court review, New Jersey businesses should ensure that their arbitration clauses meet the *Atalese* standard and, if not, amend them accordingly.

The Decision

Patricia Atalese entered into a contract with United States Legal Services Group (USLSG) for debt-relief services, which contained an arbitration clause:

Arbitration: In the event of any claim or dispute between client and the USLSG related to this Agreement or related to any performance of any services related to this agreement, the claim or dispute shall be submitted to binding arbitration upon the request of either party upon the service of that request on the other party. The parties shall agree on a single arbitrator to resolve the dispute. The matter may be arbitrated either by the Judicial Arbitration Mediation Service or American Arbitration Association, as mutually agreed upon by the parties or selected by the party filing the claim. The arbitration shall be conducted in either the county in which client resides, or the closest metropolitan county. Any decision of the arbitrator shall be final and may be entered into any judgment in any court of competent jurisdiction.

Atalese sued USLSG in New Jersey state court, claiming USLSG violated several statutes. There was no question that the dispute related to the agreement or the services provided thereunder. The trial court granted a motion compelling arbitration, the Appellate Division affirmed, but the New Jersey Supreme Court reversed.

The New Jersey Supreme Court began its analysis acknowledging FAA precedent and the “liberal federal policy favoring arbitration.” That precedent, as the *Atalese* court recognized, holds “a state cannot subject an arbitration agreement to more burdensome requirements than other contractual provisions.” The court then emphasized the flip side of this precedent, which makes clear arbitration agreements may be invalidated by “generally applicable contract defenses.” It is under this principle that the *Atalese* court attempted to square its holding with the FAA.

Specifically, the court focused on the general contract requirement that the agreement be a product of mutual assent. To meet this requirement when waiving rights under an agreement, the court emphasized a party must have “full knowledge of his legal rights and intent to surrender those rights.” The court then focused specifically on arbitration clauses: “But an average member of the public may not know—without some explanatory comment—that arbitration is a substitute for the right to have one’s claim adjudicated in a court of law.” Relying on New Jersey—as opposed to FAA—precedent, the court then noted that courts “take particular care in assuring the knowing assent of both parties to arbitrate, and a clear mutual understanding of the ramifications of that assent.” Mindful, however, of the FAA’s requirement that it not single out arbitration clauses, the court stated “the requirement that a contractual provision be sufficiently clear to place a consumer on notice that he or she is waiving a constitutional or statutory right is not specific to arbitration provisions.” It emphasized “any contractual waiver-of-rights provision” must be clear and unambiguous under New Jersey law.

The court then turned its attention to the arbitration clause. Nowhere, according to the court, did the arbitration clause put *Atalese* on clear notice that the agreement to arbitrate was a substitute for the right to have her claims adjudicated in a court of law. Importantly, the court noted that no particular form of words is necessary to waive the “time-honored right to sue,” but the provision, “at least in some general and sufficiently broad way, must explain that the plaintiff is giving up her right to bring her claims in court or have a jury resolve the dispute.” The court concluded that the arbitration provision at issue was not clear and understandable to the average consumer that she was giving up such rights.

Possibly Conflicting FAA Law

Congress passed the FAA “in response to widespread judicial hostility to arbitration agreements.” See *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1745 (2011). The petition of the *Atalese* decision to the U.S. Supreme Court argues that *Atalese* evinces the precise kind of judicial hostility the FAA was intended to prevent. A couple of these arguments highlight the point.

First, even if *Atalese*'s heightened notice standard applies to all waiver-of-rights provisions, application of that standard still singles out arbitration for disfavor. The *Atalese* court states as much when it comments that "[b]y its very nature, an agreement to arbitrate involves a waiver of a party's right to have her claims and defenses litigated in court." Despite that very nature, *Atalese* now layers in an added level of scrutiny in the form of a special, heightened notice standard for arbitration provisions. An otherwise generally applicable state-law rule that has the effect of attacking the very nature of arbitration offends the FAA. In *Concepcion*, the U.S. Supreme Court made this plain when it declared, "Although [FAA §2's] savings clause preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives." See *id.* at 1748. According to the amici curiae supporting USLSG, applying a rule that places a heightened notice burden on arbitration clauses because of their very nature interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.

Second, the amici curiae point out that *Atalese*'s holding is not premised on an individualized finding that *Atalese* did not assent to the arbitration clause. Such a finding would have been a more proper application of the general contract requirement of mutual assent because it would have applied this general principle to the particular facts in the case. Instead, the *Atalese* court relied on a blanket statement that "an average member of the public may not know" that arbitration is a substitute for court. This reasoning betrays an attack on arbitration *generally*, based on the court's understanding of what an average member of the public may or may not understand about arbitration, as opposed to an individualized assessment of what the individual consumer in this case—*Atalese*—understood. The U.S. Supreme Court's FAA precedent, supporters of USLSG argue, precludes such general state law attacks on arbitration.

Notwithstanding the possible merit of these arguments, right now and for the foreseeable future, *Atalese* is the law of New Jersey. Since September 2014, when the *Atalese* court announced its decision, several New Jersey lower courts have applied it to strike down arbitration clauses not only in other consumer contracts, but also in employment agreements as well. See, e.g., *Kelly v. Beverage Works NY*, 2014 N.J. Unpub. LEXIS 2792, (N.J. Super. App. Div. Nov. 26, 2014).

What Businesses Should Do

Atalese may have a significant impact beyond just the dispute that may arise between the parties to a single agreement. That is because many companies use form contracts that not only require arbitration, but also require parties to give up their rights to class-action claims altogether. Under the FAA, these class action waivers are generally enforceable. But for those clauses that do not meet *Atalese*'s heightened notice standard, New Jersey courts will strike them, and gone with them will be the business's protection from certain class-action claims. Thus, complying with *Atalese* is critical.

While the *Atalese* court provided only general guidance, some drafting rules will help:

- *Define Arbitration.* Explain in your clause what "arbitration" is, and do so in a way that makes it clear arbitration is different from court. Note there is no jury or judge and that the proceedings are private.
- *Include explicit waiver language.* State specifically that the parties are giving up their rights to go to court and have a jury decide the dispute in exchange for arbitration.
- *Make the clause conspicuous.* It bothered the *Atalese* court that the clause was located on page 9 of the 23-page contract. Move your clause farther up. Bold certain language or use larger font to emphasize the waiver-of-rights language and the definition of arbitration.
- *Add a separate signature line.* Consider adding a separate signature in close proximity to the arbitration clause.

In sum, unless the U.S. Supreme Court overturns *Atalese*, it is an important decision to which New Jersey businesses need to adapt. Businesses should take the time now to review their arbitration clauses and make them compliant with *Atalese*.