SUPREME COURT OF NEW JERSEY
DOCKET NO. 58,430

JULIYAH MUHAMMAD, on Behalf of Herself and All Others Similarly Situated, Plaintiff - Appellant -vs- COUNTY BANK OF REHOBOTH BEACH DELAWARE, EASY CASH, TELECASH, AND MAIN STREET SERVICE CORPORATION, JOHN DOE, AND JOHN ROE, Defendants - Respondents	**CIVIL ACTION** **ON CERTIFICATION TO THE SUPERIOR COURT OF NEW JERSEY, APPELLATE DIVISION** **Docket No. Below: A-0558-04T3** Sat Below: Judges Hon. Howard H. Kestin, P.J.A.D. Hon. Steven L. Lefelt, J.A.D. Hon. Joseph A. Falcone, J.A.D.

BRIEF OF AMICUS CURIAE LEGAL SERVICES OF NEW JERSEY

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PRELIMINARY STATEMENT

This case calls upon the Court to decide a fundamental issue of first impression -- whether New Jersey's consumer protection laws can ever realistically be applied to illegal payday loans targeted over the internet to low-income New Jersey consumers at annual interest rates of 500% and more. The defendants -- following what is today an industry-wide practice -- require all of their payday loan borrowers to execute an exculpatory pre-dispute mandatory arbitration clause that is faxed for signature before loan funds will be disbursed.[1] Among other things, the clause

- prohibits borrowers from participating in any proceeding by or on behalf of a class of borrowers, and
- requires borrowers to pursue individually any relief that might be available if the defendants violate the law in a forum that severely restricts discovery (allowing discovery *only* if

[1] Although the entire clause is headed "Agreement to Arbitrate All Disputes", the operative first sentence of the clause runs to a dense and unparseable 159 words. It is arguably impossible to determine from its plain language exactly what types of claims it actually covers – a particular difficulty for consumers without legal training. See Lynn Drysdale & Kathleen E. Keest, The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Rule of Usury in Today's Society, 51 S.C. L. Rev. 589, 632 (2000) (reporting finding that most payday loan borrowers have a high school education or less); accord Jean Ann Fox and Edmund Mierzwinski, Rent-A-Bank Payday Lending (2001), at 6, available at http://uspirg.org/reports/rentabank/Paydayreportnov13.PDF.

> the "cost is commensurate with the amount of the claim" – approximately $180 in this case).

See Pa 187; 227; 233. It is plain that the defendants' arbitration clause is not about arbitration at all. Instead, its function is to exempt these transactions from key remedies available under New Jersey's consumer protection laws.

This Court's decisions have recognized for many decades that a meaningful route to enforcement is an absolute prerequisite to the effectiveness of consumer protection laws. Exculpatory clauses such as the defendants' arbitration clause in this case are unconscionable and unenforceable -- as the Appellate Division reconfirmed just last year in Lucier v. Williams, 366 N.J. Super. 485 (App. Div. 2004), striking a consumer contract clause limiting damages to a negligible amount. As the Court's nationally-renowned consumer law precedents, including Kugler v. Romain, Riley v. New Rapids Carpet Center, Henningson v. Bloomfield Motors, Unico v. Owen, and Vasquez v. Glassboro Serv. Ass'n, make clear, it is the substantive consequences of adhesive contract provisions that guide the Court's analysis of unconscionability and public policy -- and not mere formalities or the application of any supervening canon of law. Arbitration and many other alternative dispute resolution techniques may be very effective when they offer all parties to a dispute the opportunity to make

their case, and to succeed or fail on the merits. But a procedure like the one that the defendants have chosen here -- marketed by its provider as a "do it yourself Civil Justice Reform" that will "eliminate class actions" and provide "[v]ery little, if any, discovery," Pa 519, 526 -- is the antithesis of justice, and precisely the kind of contractual deception that New Jersey's consumer law jurisprudence has long refused to enforce.

BACKGROUND – PAYDAY LOANS, MANDATORY ARBITRATION, AND CLASS ACTIONS

Payday Lending, On the Ground and Over the Internet. In many states over the past 6 to 10 years there has been a proliferation of banner advertisements that guide the Court's analysis offering "PAYDAY LOANS HERE!" blanketing urban neighborhoods, the outskirts of military bases, and other areas with significant low-income populations. See, e.g., Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina 16 (2005) available at http://www.responsiblelending.org/pdfs/rr006-Race Matters Payday in NC-0305.pdf ("The concentration of payday [lending] storefronts in North Carolina is three times greater in African-American neighborhoods than in white neighborhoods. This disparity increases as the proportion of African-Americans in a neighborhood increases."); Steven Graves & Christopher L.

Peterson, Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns at 193-94 (March 2005), available at http://www.law.ufl.edu/faculty/publications/pdf/peterson military.pdf (study of nearly 15,000 payday lenders in 20 states with 109 military bases concluding that "payday lender location patterns unambiguously show greater concentrations per capita near military populations"); Diana Henriques, Seeking Quick Loans, Soldiers Race Into High-Interest Debt, N.Y. Times, December 7, 2004, at A1 ("From Puget Sound in the Northwest to the Virginia coast, the landscape is the same: the main gate of a large military base opens onto a highway lined with shops eager to make small, fast and remarkably expensive [payday] loans, no questions asked."). The explosion of payday lending in states that permit it has been startling. See Elizabeth Renuart and Kathleen E. Keest, The Cost of Credit 294-95 (3d ed. 2005) (collecting data from numerous states). To cite just one example, a recent report concluded that the number of Utah payday loan outlets increased from 14 in 1994 to 381 in 2005. Lee Davidson, Trapped for cash: Deeper in debt; Payday lenders put many borrowers in a vicious cycle, Deseret (Utah) Morning News, Nov. 13, 2005, available at http://deseretnews.com/dn/view/0,1249,635158738,00.html ("Utah [today] has more payday loan stores than 7-Elevens, McDonalds, Burger Kings and Subway stores -- combined."). There is little doubt that payday lending is targeted at low-to-moderate income

borrowers. See, e.g., Creola Johnson, Payday Loans: Shrewd Business or Predatory Lending?, 87 Minn. L. Rev. 1, 98-103 (2002) (collecting demographic data about payday loan customers, noting several independent studies finding average borrower income of approximately $25,000); Dennis Forney, FDIC Orders Bank To Improve Payday Loan Program, Cape Gazette, May 9, 2005, available at http://www.capegazette.com/storiescurrent/0505/countybankpayday050605.html (according to County Bank executives, its payday loan borrowers "are typically people with an income in the $20,000 to $25,000 range who have been caught short for some reason").

One would look in vain, though, for payday lending enticements on bricks-and-mortar storefronts in New Jersey. There is a simple reason for this: payday lending is illegal under New Jersey state usury law, as it is under the laws of 13 other states. See Renuart & Keest, The Cost of Credit, supra at 297 n.479; Jean Ann Fox, Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury 29 (2004), available at http://www.consumerfed.org/pdfs/pdlrentabankreport.pdf (citing general usury and small loan statutes prohibiting payday loans in Arkansas, Connecticut, Georgia, Maine, Maryland, Massachusetts, Michigan, New Jersey, New York, North Carolina, Pennsylvania, Puerto Rico, Rhode Island, Vermont, the Virgin Islands, and West Virginia).

Payday lending involves initially short-term loans of $100 to several hundred dollars, usually for an initial term of one to two weeks, secured by a post-dated check or electronic funds transfer authorizations, and bearing a finance charge in the range of $15 to $35 per hundred dollars per loan term. Although they are expensive to begin with, they are even more expensive and damaging to the most financially vulnerable consumers because they are frequently rolled over or refinanced when the borrower does not have sufficient resources to pay the entire balance when they first become due. See, e.g., National Association of Attorneys General, Letter from 37 State Attorneys General to FDIC Chairman Donald E. Powell, May 10, 2005, at 1 ("In many cases, the consumer either rolls over the existing loan or immediately enters into a new loan transaction after paying off an earlier one. This process when repeated over and over again puts a consumer on a 'debt treadmill.' . . .") available at http://www.naag.org/news/pr-20050510-FDIC.php. The annual percentage rate on payday loans typically falls within a range from about 400% to over 1,200%.[2] New Jersey's

[2] LSNJ has seen proposed internet payday loans offered to New Jersey citizens with APRs in excess of 1,200%. Claims by payday lenders that such astonishing rates are necessary in order for them to be able to provide a service they contend many low income consumers need are refuted by the rapid proliferation of payday loan outlets only in the past decade (low income consumers survived virtually without payday loans before this), and by the availability of many

civil usury limit is 16% for loans in writing, and New Jersey's criminal usury cap is 30%.[3] See N.J.S.A. 31:1-1(a); 2C:21-19. No one is under any illusions: where New Jersey's usury limits apply, payday lending does not come remotely close to legality.

One exception to the applicability of New Jersey's usury laws, however, is that depository institutions chartered elsewhere claim the ability to "export" to New Jersey certain aspects of the laws of their home states with respect to credit terms -- including permissible interest rates. See, e.g., National Association of Attorneys General, Letter from 37 State Attorneys General, supra, at 1-2; Fox, Unsafe and Unsound, supra, at 11. Thus, a bank located in a state that has abrogated its usury laws (Delaware is one such state) argues that it can, if it is in fact the lender, make loans to borrowers in other states without regard to the usury laws of the borrower's home state.[4] These "charter-renting" arrangements

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sensible and straightforward alternatives. See, e.g., Center for Responsible Lending, Alternatives to Payday Lending, CRL Policy Brief No. 13 (Aug. 23, 2005), available at http://www.responsiblelending.org/pdfs/pb013-Payday Alternatives-0805.pdf.

[3] The 16% civil usury limit is currently waived with respect to most properly-licensed lenders; the 30% criminal usury limit, though, is broadly applicable to licensed non-depository lenders and to state-chartered depositories.

[4] Plaintiff's theory of the case in this litigation, of course, is that the bank that is involved is not, in fact, the lender. This is the same theory alleged with respect

have drawn significant concern from many state Attorneys General, including New Jersey's. National Association of Attorneys General, Letter from 37 State Attorneys General, supra, at 3 (urging the FDIC to advise state-chartered banks "not to lend through third party payday lenders where the payday lending entity has the predominant economic interest in the loan and the bank relationship is used as a device to avoid state regulation").

Relatively few depository institutions, however, have become involved in the business of making payday loans. Bruce

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several of the same defendants in a pending case brought by New York's Attorney General:

> County Bank, however, is the payday lender in name only. Cashnet and Telecash provide the capital for, market, advertise, originate, service and collect the payday loans. Cashnet and Telecash pay County Bank an annual fee to use County Bank's name and charter to make loans, pay County Bank a small percentage of the finance charge received on each loan, and agree to indemnify County Bank for losses and liabilities (other than credit losses) arising out of the loan operation. County Bank shares none of the risk of these loans because it receives all principal plus a substantial part of the finance charge from Cashnet and Telecash within twenty four hours of the loan's origination and prior to the loan's repayment.

People of New York v. County Bank of Rehoboth Beach, Verified Complaint filed September 23, 2003, at 2, available at http://www.oag.state.ny.us/press/2003/sep/payday_verified_complaint.pdf.

Pringle, FDIC Tells County Bank to Shape Up, Delaware Coast Press, May 4, 2005, available at http://www.delmarvanow.com/deweybeach/stories/20050504/2125757.html ("About a dozen FDIC-member banks engage in payday lending."); Fox, Unsafe and Unsound, supra at 14-17 (identifying 10 state-chartered banks recently partnering with payday lenders). In fact, County Bank of Rehoboth Beach, Delaware, the bank co-defendant in this case and one of the most significant of the banks that has been involved in the payday lending business, announced last week that it plans to cease its payday lending activities by the end of 2005. See Ted Griffith, County Bank Cuts "Payday" Ties: High Interest Loans Had Long Been Under Fire, The News Journal, Nov. 9, 2005, available at http://www.delawareonline.com/apps/pbcs.dll/article?AID=/20051109/BUSINESS/511090346/1003. A number of federally-chartered banks and thrifts that were involved in the payday lending business had all ceased their payday lending operations by 2003 as a result of enforcement actions by federal bank regulators. See, e.g., Office of the Comptroller of the Currency Annual Report, Fiscal Year 2003, available at http://www.occ.treas.gov/annrpt/2003%20Annual%20Report.pdf, at 17 ("All national banks with known payday lending activities through third-party vendors were ordered in FY 2003 to exit the payday lending business. By undertaking enforcement actions

against those banks, the OCC addressed safety and soundness concerns about the management of these payday loan programs, and ended significant consumer protection violations.")

Thus, the internet has emerged as a vehicle for marketing payday loans to consumers in states like New Jersey. See generally Jean Ann Fox and Anna Petrini, Internet Payday Lending: A CFA Survey of Internet Payday Loan Sites (2004). The internet version of the loans (which are referred to by many New Jerseyans as "internet loans" rather than payday loans) are virtually indistinguishable from their storefront counterparts.

The only typical distinction has nothing to do with the rates or terms: in order to accommodate the logistics of a largely on-line transaction, the security required for an internet payday loan is generally a pre-authorized electronic bank account debit, rather than a post-dated check.

The Rise of Mandatory Pre-Dispute Arbitration Provisions in Consumer Loan Contracts. Arbitration, and agreements to arbitrate disputes, have been with us for a long time -- and, since 1925, the Federal Arbitration Act has provided that agreements to arbitrate are entitled to enforcement "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C.A. § 2.

Most recently, arbitration agreements have been very widely adopted by sellers and lenders in various consumer sales and

credit submarkets. Credit card issuers, telephone service providers, auto dealers and finance companies, and payday lenders are among the lenders that have been quick to adopt arbitration clauses. It has been widely noted that consumer arbitration clauses have tended to take each submarket by storm, being added to the contracts of all or virtually all of the major lenders within a short time period. Ting v. AT&T, 319 F.3d 1126, 1149 (9th Cir. 2003) ("[I]f customers complained about the arbitration provision, AT&T responded with a letter informing them that 'all other major long distance carriers have included an arbitration provision in their services agreement."); Ronald J. Mann, "Contracting" for Credit, University of Texas School of Law, Law and Economics Working Paper No. 060, 104 Mich. L. Rev. ____ (forthcoming 2006) at 19-20 (noting "the widespread use of arbitration agreements in cardholder agreements" arising only since the late 1990's), available at http://www.utexas.edu/law/academics/centers/clbe/assets/mann contracting for credit.pdf. These sweeps have be so complete that, for instance, it is commonly observed that in today's multi-trillion dollar credit card market, one cannot find a cardholder agreement from a major issuer that does not contain an arbitration clause, with the exception of cards issued under the AARP brand, or by some small banks and credit unions. See,

e.g., Sid Kirchheimer, AARP Consumer Alert, Small Print, Big Trouble: A Common Contract Clause Shields Businesses, Hurts Consumers (2005), available at http://www.aarp.org/bulletin/consumer/arbitration2.html (One of the few ways to avoid arbitration clauses is to "[g]et a credit card issued by credit unions and smaller banks, which do not include BMA clauses. (Neither does the AARP credit card.)"); see also American General Fin., Inc. v. Branch, 793 So.2d 738 (Ala. 2000) (noting that virtually all of the financing companies in plaintiff's vicinity adopted arbitration clauses from 1994 to 1996). As the sources cited infra at 25-26 make clear, such a sweep has also taken place in the payday loan market, where a borrower must not just "take it or leave it" with respect to an arbitration clause in a particular lender's contract, but must "take it or leave" it with respect to every other lender, as well.

Moreover, it has also been widely recognized that after the United States Supreme Court's decision in Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 123 S.Ct. 2402, 156 L.Ed.2d 414 (2003), holding that arbitrators may certify classwide arbitration of claims where an arbitration clause is silent on the subject of class actions, all arbitration clauses will be drafted to include an express prohibition of class actions in any forum. See, e.g., Jack Wilson, "No-Class-Action Arbitration Clauses"

State-Law Unconscionability, and the Federal Arbtiration Act: A Case for Judicial Restraint and Congressional Action, 23 Quinnipiac L. Rev. 737, 762 & n.155 (2004).

What this past experience shows is that mandatory arbitration clauses that include exculpatory procedural limitations -- if allowed unchecked -- will supplant what we now know as consumer remedies.

ARGUMENT

I. THE APPELLATE DIVISION'S DECISION WOULD EFFECTIVELY ELIMINATE CONSUMER CLASS ACTIONS IN NEW JERSEY, OVERTURNING LONG-ESTABLISHED PRECEDENTS OF THIS COURT, BY AUTHORIZING EXCULPATORY MANDATORY ARBITRATION CLAUSES

A. Class Actions Are Essential to Consumers Seeking to Vindicate Their Rights. For more than 30 years, this Court has consistently recognized the fundamental role that consumer class actions fill in the enforcement of New Jersey's consumer protection laws, including but not limited to the Consumer Fraud Act. Beginning even before the legislature added private enforcement rights to the Consumer Fraud Act, the Court paved the way for consumer class actions both in New Jersey and nationwide, ruling in Kugler v. Romain, 58 N.J. 522 (1971), that the testimony of 24 consumers in an action brought by the Attorney General was a basis for declaratory relief invalidating

all of the unconscionably priced contracts induced by the seller for a purportedly educational book package. As the Court there explained:

> [T]here is a tremendous need to find a simple, inexpensive solution, which will accomplish the greatest possible good for the greatest possible number of consumers who have common problems and complaints vis-à-vis the seller. If the only available route had been pursuit of a private remedy by individual victims of the unfair practices specified by N.J.S.A. 56:8-2 such a rule would require an unrealistic expenditure of judicial energy and would be inconsistent with current trends and consumer protective legislation.

Id. at 538. For this reason, the Court held that "giving the consumer rights and remedies which he [or she] must assert individually . . . would provide little therapy for the overall public aspect of the problem." Id. at 537.

Soon thereafter, the Court recognized the crucial need for private class actions in addition to government enforcement actions, recognizing in a groundbreaking case arising from bait and switch television ads for carpeting aimed at low-income consumers that without the availability of class actions, remedies for injured consumers could readily become "illusory." Riley v. New Rapids Carpet Center, 61 N.J. 218, 225 (1972).

> The subject of consumer fraud has emerged as a major problem of our commercial scene. Being unequal to the vendor, the consumer is easily overreached. When the selling pitch is directed to the unsophisticated poor, the problem is heightened, for the dollar impact upon the victim

> is intensified and a society which provides for its poor itself feels the burden of the imposition. The reputable vendor, too, has a stake in the suppression of dishonest competition. *If each victim were remitted to an individual suit, the remedy could be illusory, for the individual loss may be too small to warrant a suit or the victim too disadvantaged to seek relief. Thus the wrongs would go without redress, and there would be no deterrence to further aggressions.* If there is to be relief, a class action should lie unless it is clearly infeasible.

Id. at 224-25 (emphasis added; footnote omitted). The Federal Trade Commission's subsequently issued a cease and desist order that followed its enforcement action against New Rapids Carpet and its principal and affiliates; notably, the order was limited to prospective injunctive relief, while it was the private class action that obtained reimbursement under the Consumer Fraud Act and other consumer protection laws on behalf of the victims of the scheme in New Jersey. See In re New Rapids Carpet Center, Inc., 90 F.T.C. 64 (1977).

In more recent years, the principles and policy determinations that animated Romain and Riley have continued to guide the Court, even in consumer cases involving bigger-ticket items. Thus, in In re Cadillac V8-6-4 Class Action, 93 N.J. 412 (1983), the Court affirmed the certification of a class in a case involving fraud, misrepresentation, warranty, and rescission claims involving luxury cars, noting that

> One frequent characteristic of a consumer class action is that the individual claims involve too small an amount to warrant recourse to litigation. Thus, the wrongs would go without redress, and the manufacturer may continue with impunity to place defective products on the market. A consequence of certification of a class action is the equalization of the ability of the parties to prepare and pay for the advocacy of their rights. Furthermore, certification can aid the efficient administration of justice by avoiding the expense, in both time and money, of relitigating similar claims.

In re Cadillac V8-6-4 Class Action, 93 N.J. at 435, citing Romain, 58 N.J. at 539-40; Riley, 61 N.J. at 225; see also Strawn v. Canuso, 140 N.J. 43, 67 (1995) (class certification appropriate in new home purchasers' Consumer Fraud Act nondisclosure case; "[f]or all of those claimants who rely on the seller's duty to disclose, it would be a hollow system of justice that awarded recovery to some homeowners while denying it to others similarly situated"). In both cases, the Court noted that the availability of classwide relief is particularly important in cases involving allegations of consumer fraud. See id. at 68 ("a class action is the superior method for adjudication of consumer-fraud claims"); In re Cadillac V8-6-4, 93 N.J. at 435 ("the class action rule should be construed liberally in a case involving allegations of consumer fraud"). The Court has also recognized that class action plaintiffs play a crucial role as private attorneys general in the dual enforcement scheme that the Legislature created under the

Consumer Fraud Act in order to ensure that remedies are available to classes of injured consumers.

> [T]he CFA, in allowing for private suits in addition to actions instituted by the Attorney General, contemplates that consumers will act as "private attorneys general." Eliminating CFA remedies for otherwise-covered practices may undermine that important and calculated legislative objective.

> Both of those aspects of the CFA--its recognition of cumulative remedies and its empowerment of citizens as private attorneys general--reflect an apparent legislative intent to enlarge fraud-fighting authority and to delegate that authority among various governmental and nongovernmental entities, each exercising different forms of remedial power. That legislative intent is readily inferable from the ongoing need for consumer protection and the salutary benefits to be achieved by expanding enforcement authority and enhancing remedial redress. When remedial power is concentrated in one agency, under-enforcement may result because of lack of resources, concentration on other agency responsibilities, lack of expertise, agency capture by regulated parties, or a particular ideological bent by agency decisionmakers. Underenforcement by an administrative agency may be even more likely where, as in this case, the regulated party is a relatively powerful business entity while the class protected by the regulation tends to consist of low-income persons with scant resources, lack of knowledge about their rights, inexperience in the regulated area, and insufficient understanding of the prohibited practice. The primary risk of underenforcement--the victimization of a protected class--can be greatly reduced by allocating enforcement responsibilities among various agencies and among members of the consuming public in the forms of judicial and administrative proceedings and private causes of action.

Lemelledo v. Beneficial Management Corp., 150 N.J. 255, 269-70 (1997) (citations omitted).

New Jersey's lower courts also have consistently echoed and applied the lessons of Romain, Riley, and their progeny in consumer cases. For instance, in a case involving allegations of common law fraud and Consumer Fraud Act violations arising from material omissions in connection with the sale of "vanishing premium" whole life insurance policies, the Appellate Division reversed the trial court's denial of class certification, noting that

> For nearly thirty years, our highest court has instructed trial courts to liberally allow class actions involving allegations of consumer fraud. That principle has been reiterated and reinforced over the years. . . .
>
> [W]e perceive from the pronouncements of our Supreme Court that there is an overarching principle of equity to consider in the application of the class certification rule. The principle is that class actions should be liberally allowed where consumers are attempting to redress a common grievance under circumstances that would make individual actions uneconomical to pursue. Should the representative plaintiff succeed in this case on liability, the relatively small amount of damages incurred by each of the policyholders and the shared common grievance based upon the withholding of material facts brings this case within that equitable principle.

Varacallo v. Massachusetts Mutual Life Ins. Co., 332 N.J. Super. 31 (App. Div. 2000); see also Varacallo v. Massachusetts Mutual

Life Ins. Co., 226 F.R.D. 207, 215-16; 233-34 (D.N.J. 2005) (approving global settlement of numerous class action cases filed nationwide following the production of more than 800,000 pages of documents and more than 25 depositions; "[S]ince the financial losses of most of the Class Members is relatively small, very few would have an interest or ability to pursue their own individual case. This is demonstrated by the relative absence of policyholder suits now pending--only eight cases pending against MassMutual in the entire United States. . . . Absent class certification, very few individuals would have the incentive or resources to bring individual claims against MassMutual.")

Similarly, in a case involving allegations that oil furnaces and boilers extensively marketed in New Jersey "contained a common design defect that caused the emission of excessive levels of carbon monoxide," the Appellate Division reversed the denial of class certification where

> Most of the individual units cost approximately $2000 or less, and other costs associated with use of the units (repair, replacement, cleaning, or the like), as claimed by plaintiffs and unrebutted by defendants, seem small. . . .
>
> [T]he trial judge expressly found that the class action method would not be a superior method of adjudication, apparently determining that individual litigation would be preferable and that "[t]he magnitude of

> the class would make it unruly." We disagree. The trial judge never expressly considered plaintiffs' claim that this would effectively end the litigation. Even if the statute of limitation is extended as explained earlier, the small amount of each claim would effectively preclude most suits. . . .
>
> "To permit the defendants to contest liability with each claimant in a single, separate suit, would, in many cases give defendants an advantage which would be almost equivalent to closing the door of justice to all small claimants. This is what we think the class suit practice was to prevent."

Delgazzo v. Kenny, 266 N.J. Super. 169, 187, 192-93 (App. Div. 1993), quoting Hohmann v. Packard Instrument Co., 399 F.2d 711 (7th Cir. 1968).

Indeed, several proposed class actions that have recently reached this Court on issues other than class certification illustrate the importance of the ability to aggregate claims holds for New Jersey's low-income consumers. The credit insurance packing claims in Lemelledo v. Beneficial Management Corp., 150 N.J. 255 (1977), for instance, involved allegations of Consumer Fraud Act and other violations arising from charges that totaled $335.28 for the named plaintiff. See id. at 260. Similarly, the claims of improper charges in the context of rent-to-own transactions raised in Perez v. Rent-A-Center, Docket No. 57,572, typically do not amount to a sufficient sum to warrant individual actions – indeed, each of the judicial

decisions on the subject in New Jersey known to LSNJ has been rendered in a class action case.

In several cases, the United States Supreme Court has made similar observations in class action cases, as have many other courts and commentators. See, e.g., Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 809, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985) ("Class actions also may permit the plaintiffs to pool claims which would be uneconomical to litigate individually. For example, this lawsuit involves claims averaging about $100 per plaintiff; most of plaintiffs would have no realistic day in court if a class action were not available."); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 161 (1974) ("A critical fact is that petitioner's individual stake in the damages award he seeks is only $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount. Economic reality dictates that petitioner's suit proceed as a class action or not at all."); see also Shaw v. Toshiba America Information Systems, Inc., 91 F. Supp. 2d 942, 958 (E. D. Tex. 2000) ("Since it would be economically unreasonable for many class members to adjudicate their separate claims individually . . ., the superiority of a class action is evident. The critical and identical factual issues require substantial discovery, expert testimony, and trial time. There is no possible reason for wanting these issues to be developed repeatedly *ad infinitum*

by individual claimants."); Yazzie v. Ray Vicker's Special Cars, Inc., 180 F.R.D. 411, 417 (D.N.M. 1998) ("[T]he large number of lower-income plaintiffs with relatively small individual claims suggests that absent the class action mechanism, it is unlikely that any one litigant would be in a position to enforce his [or her] rights individually."); 7A Wright and Miller, Federal Practice and Procedure § 1782 (3d ed. 2005) (In consumer class actions "typically the individual claims are for small amounts, which means that the injured parties would not be able to bear the significant litigation expenses involved in suing a large corporation on an individual basis. These financial barriers may be overcome by permitting the suit to be brought by one or more consumers on behalf of others who are similarly situated. . . . The knowledge that aggrieved parties may act independently through the courts to preserve their rights also could have a significant deterrent effect on businesses that might engage in practices that are harmful to the consumer and contrary to public policies expressed in federal statutes dealing with economic regulation and competition.")

Payday loans are an archetypical example of claimed overcharges that, while they have cost low-income consumers amounts of money that are very significant to them, nonetheless involve claims that simply cannot reasonably be pursued on an individual basis. There is no capacity within the Legal

Services system, and we are unaware of any actual resource within the private bar, to provide an individual payday loan borrower with representation in pursuing an individual claim in any forum. The costs of obtaining and marshalling the relevant evidence would be far too great. As a practical matter, Legal Services can usefully advise clients with respect to payday loans only in the context of bankruptcy cases, where the debts are generally dischargeable without the need for discovery. This may provide a resolution for some individuals, but only goes to highlight the fact that there is no reasonable opportunity for payday loan borrowers to vindicate their substantive non-bankruptcy rights in an individual action.

B. Consumer Class Action Prohibitions Are Exculpatory Clauses That Are Unconscionable and Unenforceable Under New Jersey Law. The decision below ignores this Court's precedents in its unconscionability analysis, as well. The Appellate Division first correctly concluded that the fact that the plaintiff in this case had no choice but to agree to the arbitration and anti-class action provisions in order to complete the transaction made this a contract of adhesion. The Appellate Division then, again correctly, concluded that this fact alone does not render these contract provisions unconscionable. At this point in the analysis, however, the

Appellate Division abandoned settled New Jersey law, and ended its unconscionability analysis. To the contrary, it is at this point that substantive unconscionability analysis begins. Moreover, such an unconscionability analysis under state law is entirely consistent with the Federal Arbitration Act and its interpretation by the U.S. Supreme Court. See Jack Wilson, "No-Class-Action Arbitration Clauses," State-Law Unconscionability, and the Federal Arbtiration Act: A Case for Judicial Restraint and Congressional Action, 23 Quinnipiac L. Rev. 737, 835 (2004), citing Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, (1996).

The starting point of this Court's precedents recognizing the need for heightened scrutiny of contracts of adhesion was Henningson v. Bloomfield Motors, Inc., 32 N.J. 358 (1960). There, the Court noted that

> The traditional contract is the result of free bargaining of parties who are brought together by the play of the market, and who meet each other on a footing of approximate economic equality. . . . But in present-day commercial life the standardized mass contract has appeared. It is used primarily by enterprises with strong bargaining power and position. The weaker party, in need of the goods or services, is frequently not in a position to shop around for better terms . . . . Such standardized contracts have been described as those in which one predominant party will dictate its law to an undetermined multiple rather than to an individual. They are said to resemble a law rather than a meeting of the minds.

> . . .
>
> [The legislature] has imposed an implied warranty of merchantability as a general incident of sale of an automobile by description. The warranty does not depend upon the affirmative intention of the parties. It is a child of the law; it annexes itself to the contract because of the very nature of the transaction. The judicial process has recognized a right to recover damages for personal injuries arising from a breach of that warranty. The disclaimer of the implied warranty and exclusion of all obligations except those specifically assumed by the express warranty signify a studied effort to frustrate that protection. . . . The lawmakers did not authorize the automobile manufacturer to use its grossly disproportionate bargaining power to relieve itself from liability . . . . [W]e are of the opinion that Chrysler's attempted disclaimer of an implied warranty of merchantability and of the obligations arising therefrom is so inimical to the public good as to compel an adjudication of its invalidity.

Id. at 389-90, 404 (citations other than quotation source omitted); see also Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965) ("[u]nconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party"). One of the Court's particular concerns in Henningson was the fact that the only three major auto manufacturers selling in the United States at the time – Chrysler, Ford, and General Motors – all had adopted the limitation-by-warranty the Court found objectionable for substantive reasons. Consumers, even if they

succeeded in finding, reading, and understanding the substance of the warranty clause, could not have chosen to go to another manufacturer to find a better alternative.

The same situation pertains today with respect to payday loan borrowers. As noted by a supervising examiner at the Federal Reserve Bank of Philadelphia, "The inclusion of mandatory arbitration clauses within payday loan contracts appears to be standard operating procedure among payday lenders and banks that partner with payday lenders to originate payday loans." Robert W. Snarr, Jr., No Cash 'til Payday: The Payday Lending Industry, Federal Reserve Bank of Philadelphia Compliance Corner, 1st Quarter 2002, at CC1, CC2, available at http://www.phil.frb.org/src/srcinsights/srcinsights/pdf/ccq1.pdf ; accord Jean Ann Fox and Anna Petrini, Internet Payday Lending: A CFA Survey of Internet Payday Loan Sites 24 (2004), available at http://www.consumerfed.org/pdfs/Internet Payday Lending113004.PDF ("The use of mandatory arbitration clauses is almost universal in the payday loan industry . . ."); Christopher L. Peterson, Taming the Sharks: Towards a Cure for the High-Cost Credit Market 234-35 (2004) ("If lender liability for unfair business practices aims to correct the externalities associated with credit contracts, the growing predominance of mandatory binding arbitration clauses is an attempt to circumvent that market

correction. . . . [N]owhere have mandatory arbitration clauses caught on more quickly and with such aggressive draftsmanship as in the high-cost credit market.").[5]

In particular, this Court has also recognized the need for heightened scrutiny of adhesive consumer credit contracts:

> Mass marketing in consumer goods, as in many other commercial activities, has produced standardized financing contracts. Henningson v. Bloomfield Motors, Inc., 32 N.J. 358, 389, 161 A.2d 69, 75 A.L.R.2d 1 (1960). As a result there is no real arms-length bargaining between the creditor (seller-financer) and the consumer, beyond minimal negotiating about amount of credit, terms of installment payment and description of the goods to be purchased, all of which is accomplished by filling blanks left in the jungle of finely printed, creditor-oriented provisions. In the present case the purchase contract was a typical standardized finely printed form, focused practically in its entirety upon the interests of the seller and its intended assignee. Little remained to be done but to describe the stereo record player and to fix the price and terms of installment payment by filling in the blanks. Even as to the matter inserted in the blanks, it cannot be said that there was any real bargaining; the seller fixed the price of the albums, and, as we shall see, the plaintiff Unico as the financer for Universal established the maximum length of the installment payment period under its contract with Universal. The ordinary consumer goods purchaser more often than not does not read the fine print; if he did it is unlikely that he would understand the legal jargon, and the significance of the clauses is not explained to him. This is not to say that all

[5] In light of the United States Supreme Court's decision in Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 123 S.Ct. 2402, 156 L.Ed.2d 414 (2003), it has been widely observed that no arbitration clauses drafted after the date of the decision will fail to include a concurrent prohibition on participation in class actions in court or in the arbitration forum.

> such contracts of adhesion are unfair or constitute imposition. But many of them are, and the judicial branch of the government within its sphere of operation in construing and applying such contracts must be responsive to equitable considerations.

Unico v. Owen, 50 N.J. 101, 111 (1967); see also Vasquez v. Glassboro Service Ass'n, Inc., 83 N.J. 86, 103-04 (1980) (migrant farmworker's adhesive employment contract analogous to contract of "a consumer who must accept a standardized form contract to purchase needed goods and services;" clause providing for immediate eviction following discharge held unconscionable); Gladden v. Cadillac Motor Car Div., 83 N.J. 320, 334-35 (1980) ("[W]e are here dealing with . . . a contract document that is not the product of mutual negotiation or cooperatve draftsmanship. The purchaser of a mass-produced consumer article with a standard warranty form . . . has no opportunity to bargain over its terms. . . . The consumer must ordinarily place considerable reliance upon the fairness and good faith of the manufacturer and its dealers. It has therefore been recognized that the reliance which a consumer necessarily reposes in a seller engenders a corresponding responsibility on the sellers."); Shell Oil Co. v. Marinello, 63 N.J. 402, 409 (1973), cert. denied, 415 U.S. 920, 94 S.Ct. 1421, 39 L.Ed.2d 475 (1974) (invalidating termination provision in oil company's lease and dealer agreement because grossly

"disproportionate bargaining position" between parties created unfair agreement that violated public policy); Solari Industries, Inc. v. Malady, 55 N.J. 571, 576 (1970) ("When an employer, through superior bargaining power, extracts a deliberately unreasonable and oppressive noncompetitive agreement he is in no just position to seek, and should not receive, equitable assistance from the courts."); Ellsworth Dobbs, Inc. v. Johnson, 50 N.J. 528, 553-4 (1967) ("Courts . . . have grown increasingly sensitive to imposition . . . on members of the public by persons with whom they deal, who through experience, specialization, licensure, [or] economic strength or position . . . have acquired such expertise or monopolistic or practical control in the . . . transaction . . . as to give them an undue advantage. Grossly unfair contractual obligations resulting from the use of such expertise or control by the one possessing it, which results in assumption by the other contracting party of a burden which is at odds with the common understanding of the ordinary and untrained member of the public, are considered unconscionable and therefore unenforceable."); Paul D. Carrington and Paul Y. Castle, The Revocability of Contract Provisions Controlling Resolution of Future Disputes Between the Parties, 67 Law & Contemp. Problems 207, 218 (2004) (Mandatory arbitration clauses "are not the

subject of agreement in the moral sense on which the law of contract rests.").

II. LIMITATIONS ON DISCOVERY SO SEVERE AS TO BE EXCULPATORY ARE UNCONSCIONABLE AS A MATTER OF STATE LAW

The instant case involves the Consumer Fraud Act and New Jersey's civil and criminal usury laws, all created to protect consumers. The contract provision at issue requires consumers to pursue any relief that might be available if the defendants violate the law individually, in a forum that would allow discovery *only* if the "cost is commensurate with the amount of the claim" -- here approximately $180. Indeed, the arbitration provider chosen by defendants promises a "do it yourself Civil Justice Reform" that will "eliminate class actions," and provide a forum allowing "[v]ery little, if any, discovery." Pa 519, 526.[6]

Plaintiff's theory of the case is that one of the defendants -- a federally insured state-chartered bank that has recently

[6] New Jersey courts have long recognized the dangers of these types of claims in connection with arbitration:

> [T]he practice of arbitrators of conducting themselves as champions of their nominators is to be condemned as contrary to the purpose of arbitrations, and as calculated to bring the system of enforced arbitrations into disrepute. . . . [A party-designated arbitrator] should sedulously refrain from any conduct which might justify even the inference that either party is the special recipient of his solicitude or favor.

Barcon Associates, Inc. v. Tri-County Asphalt Corp., 86 N.J. 179, 218-19 (1981), quoting American Eagle Fire Ins. Co. v. New Jersey Ins. Co., 148 N.E. 562, 564 (N.Y. 1925) (Pound, J.).

announced its exit from the business -- is a lender in these transactions in name only, and shares none of the risk of the highly profitable high-interest loans made and marketed by the other defendants to low-income New Jerseyans. These complicated matters -- amounting to allegations of a multi-party conspiracy to elude state consumer protection laws in long-distance technically sophisticated transactions -- cannot be sufficiently presented without a chance for full discovery.

It is axiomatic that parties cannot litigate complex cases effectively without adequate discovery. Cases involving claims which invoke the several consumer protection laws are often complex. The Third Circuit stated that an action that involved "a complex web of state and federal . . . consumer protection claims" would require substantial discovery and experts to testify on "complex issues." In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation, 55 F.3d 768, 812 (3d Cir. 1995). While that case involved class action litigation, it highlights the need for plaintiffs in consumer cases in New Jersey to have more than the costs of damages in discovery.

Several New Jersey cases have directly recognized the central importance of meaningful discovery. In Greate Bay Hotel & Casino v. City of Atlantic City and Atlantic County Board of Taxation, the Appellate Division stated that, "County Boards are

suited to quick and efficient review . . . where extensive discovery is not required and the issues and anticipated testimony are uncomplicated." Greate Bay Hotel & Casino v. City of Atlantic City and Atlantic County Board of Taxation, 21 N.J. Tax 122, 126-27 (App. Div. 2003). The Appellate Division understood that a county board of taxation was not equipped to handle cases which involved matters that would not allow either side to receive a fair and just hearing. Id. at 127.

In State v. Hollup, 253 N.J. Super. 320 (App. Div. 1992), the Appellate Division examined discovery issues in a municipal court setting. The court stated that, "[a]s municipal courts mature and become more responsible for the disposition of more complex, more serious . . ., more communally important cases, more formal practices become essential," and emphasized that, "in the more significant cases, a more careful, thorough procedure is warranted. There is a recognizable difference in the analysis of the discovery in a drunk driving case as compared to one involving a stop light violation." Id. at 326.

As arbitration clauses become the only way that corporations will contract with consumers and thus "more communally important", consumers must be afforded a "more careful, thorough procedure." This procedure must include sufficient discovery, without which consumers like Ms. Muhammad

will have no meaningful opportunity to vindicate their rights under the State's consumer protection laws.

III. NOTHING IN THE FEDERAL ARBITRATION ACT OR IN STATE LAW OR PUBLIC POLICY REQUIRES COURTS TO, OR SUGGESTS THEY SHOULD,ENFORCE CLASS ACTION BARS IN CONSUMER SETTINGS

The Federal Arbitration Act (the "FAA") applies to agreements to arbitrate. Class action prohibitions, however, are not agreements to arbitrate, and they do not become agreements to arbitrate by virtue of being placed in a clause that, in other respects, relates to arbitration. Accordingly, the question of whether such a contract provision is enforceable as a matter of state law does not implicate any legal constraints or policy imperatives under the FAA.

This fundamental confusion has led some courts to conclude that the FAA requires that class action waivers be upheld if they were executed in conjunction with an agreement to arbitrate. Numerous state and federal courts, however, have held class action waivers in arbitration clauses render them unconscionable and unenforceable. See, e.g., Discover Bank v. Superior Court, 113 P.3d 1100 (Cal. 2005); West Virginia ex rel. Dunlap v. Berger, 567 S.E.2d 265 (W. Va. 2002); Whitney v. Alltell Communications, Inc., __ S.W.3d __, 2005 WL 1544777 (Mo. App. 2005) ("The Court is persuaded by the line of cases holding

that an arbitration clause that defeats the prospect of class-action treatment in a setting where the practical effect affords the defendant immunity is unconscionable."); Kinkel v. Cingular Wireless Communications, Inc., 828 N.E.2d 812 (Ill. App. 2005); Eagle v. Fred Martin Motor Co., 809 N.E.2d 1161, 1183 (Ohio App. 2004); Powertel v. Bexley, 743 So. 2d 570 (Fla. App. 1999); Discover Bank v. Shea, 326 N.J. Super. 200 (Law Div. 2001), Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003); Luna v. Household Fin. Corp. III, 236 F. Supp. 2d 236 (W.D. Wash. 2002); Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1104, 1105 (W.D. Mich. 2000); Jean R. Sternlight and Elizabeth J. Jensen, Using Arbitration to Eliminate Class Actions: Efficient Business Practice or Unconscionable Abuse?, 67 Law & Contemp. Problems 75, 78 n.13 (2004) (collecting decisions as of 2003 holding class action prohibitions in arbitration clauses unconscionable or unfair).

With respect to New Jersey State law, the Appellate Division erred below in its interpretation of prior judicial decisions on New Jersey's public policy concerning arbitration. A review of this Court's precedents reveals a public policy favoring, at most, the enforcement of arbitration agreements *entered into between parties of equal bargaining power*. Tracing the relevant line of authority back to its sources, the Appellate Division below relied on its prior decision in Gras v.

Associates First Capital Corp., 346 N.J. Super. 42 (App. Div. 2001) as support for a putative "compelling public policy favoring arbitration as a means of dispute resolution and requiring liberal construction of contracts in favor of arbitration," even in the context of adhesion contracts. See id. at 54. Gras, in turn, relied for this proposition on this Court's decision in Marchak v. Claridge Commons, Inc., 134 N.J. 275 (1993). The Marchak Court, though noting that "arbitration is a favored form of relief," id. at 281, nonetheless allowed the plaintiff's suit to go forward in court because the arbitration clause at issue was not mandatory. The court specifically noted in the course of its analysis that the plaintiff "was represented by counsel at all relevant times, including when he signed the [contract at issue]," and that there was therefore "no[] inequality of bargaining power between the parties." Id. at 282-83. Thus, nothing in Marchak suggests support for a "compelling public policy" in favor of enforcing arbitration clauses in adhesion contracts.

Moreover, Marchak cited as its authority a prior *commercial* arbitration case, Barcon Assocs. v. Tri-County Asphalt Corp., 86 N.J. 179 (1981), together with the sources cited in that decision "favoring arbitration." Careful reading of Barcon reveals that what the Court said there is that "*Commercial* arbitration is a long-established practice in New Jersey

consistently encouraged by the Legislature." Id. at 186 (emphasis added). Indeed, a review of each of the cases cited by the Barcon court for this proposition reveals that they were all commercial (or labor union) arbitration cases.[7] Accordingly, to the extent that there is a policy preference in favor of arbitration of commercial disputes that can be discerned from this Court's prior decisions, it is not applicable here.

[7] See Hudik-Ross, Inc. v. 1530 Palisade Ave. Corp., 131 N.J. Super. 159 (App. Div. 1974) (commercial construction contract); Kearny PBA Local # 21 v. Town of Kearny, 81 N.J. 208 (1979) (contract between police officers' association and municipality); Daly v. Komline-Sanderson Engineering Corp., 40 N.J. 175 (1963) (arbitration concerning corporate lawyer's legal fees); Ukrainian National Urban Renewal Corp. v. Muscarelle, Inc., 151 N.J.Super. 386 (App. Div. 1977), certif. denied, 75 N.J. 529 (1977) (validity of arbitration award between contractor and subcontractor); Public Utility Construction and Gas Appliance Workers, Local 274 v. Public Service Elec. & Gas Co., 35 N.J.Super. 414 (App. Div. 1955), certif. denied, 19 N.J. 333 (1955) (arbitration clause in collective bargaining agreement); Eastern Engineering Co. v. City of Ocean City, 11 N.J. Misc. 508 (Sup. Ct. 1933) (arbitration between city and sewer contractor).

CONCLUSION

For all of the foregoing reasons, this Court should reverse the Appellate Division's decision affirming the trial court's August 18, 2004, orders compelling arbitration and staying plaintiff's action, and discovery therein, pending arbitration.

Dated: November 17, 2005

Respectfully submitted,
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