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SUPREME COURT

Strict Interpretation Eschewed

Court focuses on discerning intent of contractual or statutory language

By Arthur L. Raynes

There were several important commercial cases this past term. Three highlighted the Court's refusal to be bound by restrictive interpretations of contractual or statutory language. Instead, the Court turned its focus to discerning intent.

One of the emerging trends this term had to do with the dissents of Justice Roberto Rivera-Soto. Four of the commercial cases referred to in this piece were six-to-one decisions, with Justice Rivera-Soto writing dissents. Justice Rivera-Soto has evidenced what might be termed a strict interpretive bent, in that he appears unwilling to join with the majority to expand the language of contracts or statutes, even to fulfill contractual or legislative intent.

The issue in *Ryan v. American Honda Motor Co.*, 186 N.J. 431 (2006), was whether a motor vehicle lessee may invoke the provisions of a manufacturer's warranty under the Magnuson-Moss Warranty Federal Trade Commission Improvement Act. 15 U.S.C.A. §§ 2301-2312.

Plaintiff, Christopher Ryan, entered into a vehicle lease with Burns Honda, an authorized dealer and repair facility for defendant, American Honda Motor Co., Inc. The vehicle, a new 1999 Honda Passport, carried a three-year/36,000 mile manufacturer's new vehicle limited warranty, as well as several parts and equipment warranties. Ryan's lease agreement included the following relevant provisions in the "vehicle warranties" section: 1) If

the vehicle is new, it is covered by the Manufacturer's New Vehicle Warranty; and 2) lessor assigns to me all of its rights in the above specified warranties. Fifteen months and 22,000 miles into the 36-month lease term, Ryan's vehicle manifested engine problems. Burns Honda denied coverage under the manufacturer's warranty. Ryan continued to have problems with the vehicle despite numerous repairs and it was repossessed in November 2001.

A cause of action was asserted under Magnuson-Moss, apparently to take advantage of the fee-shifting element of that statute. In order to invoke the Act, a plaintiff must meet one of three definitions of "consumer": 1) A buyer (other than for the purposes of resale) of any consumer product; 2) any person to whom such product is transferred during the duration of an implied or written warranty (or service contract) applicable to the product; or 3) any other person who is entitled by the terms of such warranty (or service contract) or under applicable State law to enforce against the warrantor (or service contractor) the obligations of the warranty (or service contract).

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The trial court found that Ryan was not a "consumer" and, therefore, not able to invoke Magnuson-Moss. The Appellate Division reversed and found that a lessee is indeed a consumer under Magnuson-Moss. The Supreme Court granted American Honda's petition for certifica-

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tion.

The Court ruled in favor of Ryan. It held that the assignee of the dealer's warranty is entitled to enforce the warranty under New Jersey law.

The Court looked to *Voekler v. Porsche Cars N. Am. Inc.*, 353 F.3d 516 (7th Cir. 2003), for guidance. *Voekler* found that a new car lessee falls within the third definition of consumer under Magnuson- Moss. The reasoning was that when the dealer assigned plaintiff the rights under the manufacturer's warranty, plaintiff was entitled under Illinois law to enforce the warranty, rendering him a category three consumer.

The question for the Court became whether "applicable State law" in New Jersey entitled a lessee such as Ryan to enforce its warranty. The Court referred to *Miller Auto Leasing Co. v. Weinstein*, 189 N.J. Super 543, 546 (Law Div.), aff'd o.b., 193 N.J. Super 328 (App. Div.), certif. denied, 97 N.J. 676 (1984), for support that New Jersey state law afforded a lessee the manufacturer's warranty protection.

Justice Rivera-Soto dissented on the grounds that Ryan, as a lessee, did not qualify as a "consumer." In relying on New York law, Justice Rivera-Soto concluded that a consumer must be "a purchaser of the product under warranty." In a pointed footnote, Justice Rivera-Soto also noted that the plaintiff had other available remedies under law, but the difference was that only under Magnuson-Moss would the plaintiff have the claim for attorneys' fees. In that footnote, Justice Rivera-Soto wrote:

> We therefore now expand the reach of the Magnuson-Moss Warranty Act not because there was a gap in remedies to the consumer, but to allow for attorney fee-shifting that is generally disfavored in our law, but otherwise permitted under the Magnuson-Moss Warranty Act.

Conway v. 287 Corporate Center Associates, 187 N.J. 259 (2006), also involved language interpretation. The issue there was whether the parol evidence rule barred admission of extrinsic evidence to explain the meaning of a bonus provision in a lawyer's retainer agreement. The Court started with the assumption that the written terms of the agreement were clear.

The Court compared the "restrictive view" of Professor Williston with what it termed the "expansive view" of Professor Corbin. Under the Williston view, evidence can only be admitted if the language of the contract is unclear. By contrast, the Corbin view holds that parol evidence of the circumstances is always admissible in aid of the interpretation of an integrated agreement. The Court continued, "This is so even when the contract on its face is free from ambiguity." Clearly, the Court confirmed that in New Jersey a most expansive view of parol evidence will prevail.

Defendants, 287 Corporate Center Associates, a New Jersey partnership through its individual partners, Angelo Cali, John Cali, and Edward Leshowitz, purchased a 39.1 acre tract in Bridgewater. Defendants planned to develop the property for subsequent sale or lease, but numerous issues had to be resolved before development could occur. In 1993, they contacted attorney (later Judge) Bernard Conway to investigate the possibility of suing Bridgewater for its actions in essentially rendering the property undevelopable. In 1994, Conway forwarded to defendants a retainer agreement that explained the process of litigation, outlined the federal cause of action, and noted that the retainer agreement provided for a bonus to be paid if Conway were "successful in obtaining a zone change and the property was either sold or the partnership was successful in constructing a building and selling or renting it in the future."

Specifically, the agreement provided for a bonus fee of $375,000 "should the lawsuit produce any modification of the zone change which permits construction of any type, residential or commercial or the sale or lease of the property to a third person." If a bonus was earned, it was to be paid in three installments of $125,000 on January 2 of each year following the sale or lease of the property or issuance of a certificate of occupancy from the township.

The case was later transferred to attorney Roy Kurnos, who took the case and signed a retainer agreement without a bonus provision. Later, Conway wrote a letter to the defendants saying that he was assigning all the rights under his retainer agreement to Kurnos and seeking confirmation that the Associates would honor it. The Associates did not respond, while Kurnos wrote Conway and advised that he had signed a retainer without a bonus provision.

The lot was rezoned to a single commercial zone on March 4, 1996. At some point Conway met with the defendants to confirm that the bonus provision was still in force, but the defendants replied that the access issue was never resolved and the property had not been developed. Conway then passed away and his estate filed suit. The estate was awarded the $375,000 bonus fee plus legal fees and interest by the trial judge. The trial judge found that the zoning issue was settled at a mediation that Conway attended, and the change in zoning was all that was required to trigger the bonus. After an extensive procedural history, which included a side-trip to the Appellate Division, the Supreme Court ultimately reversed that initial trial court decision and determined that parol evidence was properly admitted in a retrial, and that the bonus properly was denied.

Conway's estate argued that parol evidence should not have been admitted because the retainer agreement was free from ambiguity. It also contended that it was error to find that the three documents — the retainer, the memorandum, and a proposed complaint — constituted an integrated document. Plaintiff maintained that the integrated documents doctrine only applies when separate documents indicate a clear intent to form one agreement, which was absent here. Further, plaintiff argued that the extrinsic evidence only served to make the contract unclear and, therefore, should not have been considered.

The defendants argued that the Appellate Division correctly interpreted New Jersey law governing the admission of parol evidence to allow extrinsic evidence of the circumstances and the context in which the parties entered into the agree-

ment. Thus, defendants argued that parol evidence was admissible not to change the meaning of the retainer agreement, but to explain it. defendants also argued that the payment structure, providing for payment in three annual installments each year following the sale or lease of the property or the issuance of a certificate of occupancy, supported the understanding that "Conway would benefit from the bonus fee if and when the development of the property was permitted as the result of Conway's litigation strategy." Because the property was never sold or leased, or issued a certificate of occupancy, defendants contended that Conway was not entitled to the bonus.

In permitting parol evidence, the Court ruled that the bonus was not earned because access to the property was not obtained. The Court found that the extrinsic evidence clearly established that the parties intended that the bonus would be earned only if Conway were successful in obtaining both a zoning change and access to the property to permit development.

The Court followed *Atl. Northern Airlines v. Schwimmer*, and considered all of the relevant evidence that assisted in determining the parties' intent and meaning of the contract. The Court noted that such evidence could include consideration of the particular contractual provision, an overview of all the terms, the circumstances leading up to the formation of the contract, custom, usage and the interpretation placed on the disputed provision by the parties' conduct. Thus, the words of the contract will not always control.

The Court permitted a broad use of extrinsic evidence to achieve the ultimate goal of discovering the intent of the parties. The Court stated that it is only after the meaning of the contract is discerned that the parol evidence rule comes into play to prohibit the introduction of extrinsic evidence to vary the terms of the contract.

In dissent, Judge Rivera-Soto stated that when the contract is clear, a court is bound to enforce the contract as it finds it. The law should not make a better contract for sophisticated parties than they themselves had seen fit to enter into, nor alter it for the benefit of one party and to the detriment of the other. The judicial function of the court is to enforce the contract as it is written. The dissent stated that the retainer agreement was absolutely devoid of any language whatsoever proposing access as a condition upon which the bonus of $375,000 would be paid. Instead, the payment was predicated entirely on obtaining a zone change, which was obtained. The retainer agreement was the complete and integrated expression of the parties, as evidenced by their acknowledgment and attestation of the agreement.

The issue in *Perez v. Rent-A-Center*, 186 N.J. 188 (2006), was whether rent-to-own contracts are subject to certain consumer protection statutes. Specifically, the parties questioned whether the following applied to such contracts: the Retail Installment Sales Act (RISA), N.J.S.A. 17:16C-1, et seq.; the interest rate cap in the criminal usury statute, N.J.S.A. 2C:21-19; and the Consumer Fraud Act (CFA), N.J.S.A. 56:8-1, et seq.

Rent-to-own transactions offer immediate access to household goods for a relatively low weekly or monthly payment, typically without any down payment or credit check. Between March 2001 and May 2002, Plaintiff Hilda Perez entered into five rent-to-own contracts with Rent-A-Center to become the owner of used furniture, a used washer and a new dryer, a used DVD player and television, a new computer, and a used large screen television and cabinet. Together, all the items Perez had rented had a cash price of $9,301.72; however, if she paid the weekly rates and the additional option payments, she would assume ownership having expended $18, 613.32. By May 2002, Perez had paid $8,156.72. She stopped paying in May 2002.

Plaintiff's expert at trial calculated that by the time of purchase, the annual interest rate on the various items would have been approximately 80 percent.

Rent-A-Center filed a small claims complaint seeking money damages against Perez arising out of her failure to pay for or return the rental items. In turn, Perez sued in Superior Court, alleging that her rent-to-own contracts violated RISA and the CFA because the contracts imposed an interest rate in excess of the 30 percent permitted under the criminal usury statute. Rent-A-Center apparently dropped the small claims complaint and instituted a counterclaim for breach of contract and conversion against Perez.

The Court ruled in favor of Perez, holding that the statutes at issue applied.

The decision is unusual in two respects. First, the Court undertook an interesting discussion of the historical distinction in the law between the taking of interest in connection with the sale of goods on the one hand, and the taking of interest on a loan of money on the other hand. Historically, usury laws applied only to interest on money loans. The theory was that "a purchaser is not like the needy borrower, a victim of a rapacious lender, since he can refrain from the purchase if he does not choose to pay the price asked by the seller." The distinction led to the judicial coining of the phrase "term price differential" to differentiate interest on money from interest on purchases. In *Perez*, the Court completed the evisceration of this distinction in New Jersey.

Second, the case is unusual because the Court relied extensively on sociological and statistical data. It is fair to say that a linchpin of the Court's reasoning was based on the sociological conclusions relating to the effects of those contracts on the working poor. In dissent, Justice Rivera-Soto had little patience for such social concerns:

> Many may consider the Rent-To-Own industry abhorent. However, setting aside that particularly noxious version of noblesse oblige, the fact remains that merchants that offer goods on a rent-to-own basis nevertheless satisfy an important need.

The Court went on to look to the legislative intent in determining the scope of RISA, which was to protect the public. By including conditional sales, chattel mort-

gages, security interests and similar instruments within the protections of RISA, the Legislature signaled that it intended to seep into RISA as many agreements as possible, even those that did not strictly fall within a denominated category. Thus, the Court determined that RISA intended to cover agreements like the ones between Rent-A-Center and Perez. The Court found that Perez's leases were similar to transactions that had been judicially recognized as conditional sales: possession of the goods was transferred to Perez with title to pass upon the satisfaction of the lease terms and the payment of the option price. If Perez ceased paying, title would not pass. Because RISA did not specifically define conditional sales, the Court said, at the very least, the agreement was a "similar instrument" and thus still covered under RISA.

Rent-A-Center had maintained that because there was no obligation to buy, the contract did not fall within RISA. The Court was not satisfied that the cancellation provision in the rent-to-own contract altered the fundamental nature of the transaction. Its conclusion was bolstered by the fact that the majority of rent-to-own contracts are intended for and, in fact, result in ownership, not cancellation. The Court reasoned that even though the transactions seem like short-term leases, they operate more like installment contracts — consumers who purchase goods through rent-to-own contracts may not incur debt, but they still implicitly pay interest in return for the ability to pay for goods over time. The Court further reasoned that rent-to-own customers may not have an absolute obligation to repay a principal amount, but their situation is analogous to that of ordinary buyers on credit in that they must either forfeit possession of a good or continue to pay for it.

Justice Rivera-Soto's dissent would have determined that RISA did not apply because the transactions involved did not necessarily lead to purchases. Justice Rivera-Soto wrote:

> If there is a need to regulate the rent-to-own industry — a need certainly not demonstrated in this record — then the source of that regulation should be legislative or executive action, and not a cobbled-together judicial cure for a perceived but unsubstantiated ill. Because a rent-to-own contract is not a 'retail installment contract' under RISA, the provisions of RISA are simply inapplicable by their own terms.

Addressing the criminal usury issue, that statute prohibits the taking of any money or other property as interest on the loan or on the forbearance of any money in excess of 30 percent per annum. The Court found a legislative intent to create a seamless scheme pursuant to which consumers and sellers are accorded flexibility to negotiate interest rates to reflect market conditions subject to the 30 percent safety cap.

Finally, the Court also held that the CFA applied, rejecting Rent-A-Center's argument that the CFA should not apply because the transaction was subject to comprehensive regulation. Rent-A-Center cited *Lemelledo v. Beneficial Management Corp. of America*, 150 N.J. 255 (1997), in that regard. The Court distinguished *Lemelledo* because there was no conflict between the CFA and the regulatory scheme of RISA.

On Aug. 9, 2006, the Supreme Court issued decisions in the companion cases, *Muhammad v. County Bank of Rehoboth Beach*, A-39-05 (Aug. 9, 2006) and *Delta Funding Corp. v. Harris*, A-44-05 (Aug. 9, 2006). The prevailing theme of both cases was the unconscionability of arbitration provisions contained in consumer loan contracts of adhesion. In *Muhammad*, the focus of the Court's decision was whether a class-action waiver provision was unconscionable. In *Delta Funding*, the Court considered the unconscionability of the overall agreement.

The facts of *Muhammad* involved a student who had received a short-term loan from the defendant in the amount of $200 plus a $60 finance charge. The loan documents contained an arbitration obligation that prohibited the borrower from participating in class-action arbitrations, as well as bringing, joining or participating in class actions, whether brought in courts or through arbitration. The plaintiff eventually sued the bank, alleging violations of the Consumer Fraud Act, the civil usury statue and the state RICO statute. The bank moved to compel arbitration, which the plaintiff opposed on the grounds that the class-action waiver provisions were unconscionable. The motion to compel was granted by the trial court and affirmed by the Appellate Division, relying on its decision in *Gras v. Associates First Capital Corp.*, 346 N.J. Super. 42 (App. Div. 2001) (holding that class-action waiver provisions are not per se unconscionable).

Relying on the four factors to consider in determining the unconscionability, set forth in *Rudbart v. North Jersey District Water Supply Comm.*, 127 N.J. 344, 356 (1992), and the public policy behind class actions, the Court concluded that the class-action waiver provisions were unconscionable essentially because they acted to bar the plaintiff from "pursuing her statutory consumer protection rights" and shielded the bank from "compliance with the laws of this State."

One of the primary factors considered by the Court was the small amount of the plaintiff's claim, with the Court acknowledging that without the class action vehicle available to the plaintiff, or others similarly situated, most people would not bother pursuing litigation for such a low dollar amount. As such, the class-action waivers were seen as exculpatory clauses.

Additionally, the Court specifically noted that its decision was not at odds with *Gras*, because *Gras* had not considered the impact of such waivers in connection with low-value consumer loans.

Finally, the Court determined that the waiver provisions were severable from the remainder of the arbitration agreement.

As was his trend in the field of commercial law this year, Justice Rivera-Soto dissented for the reasons relied upon by the trial court and Appellate Division, namely, *Gras'* holding that class-action

waivers are not per se unconscionable and its consideration of the *Rudbart* factors.

In *Harris*, the plaintiff entered into a mortgage loan contract with Mrs. Harris for the amount of $35,000. The loan agreement contained a class-action waiver provision similar to that contained in the *Muhammad* agreement, as well as provisions (1) excluding foreclosure proceedings from arbitration; (2) permitting the arbitrator to decide who would be responsible for paying the administrative costs; (3) indicating that each party was responsible for his own attorneys' fees; and (4) requiring the appellant to bear the costs of appeal regardless of the outcome.

After Mrs. Harris defaulted, foreclosure proceedings were instituted in New Jersey Superior Court and Mrs. Harris responded that the entire agreement was unconscionable. (Prior to the foreclosure proceedings, Delta Funding had assigned the loan to Wells Fargo. Wells Fargo was the party seeking foreclosure, so Mrs. Harris's claims were in the form of a third-party complaint against Delta Funding.) Delta filed a petition in federal court, seeking to compel arbitration of Mrs. Harris's affirmative claims against it. That motion was granted. Mrs. Harris appealed to the Third Circuit, which issued a petition order to the New Jersey Supreme Court to resolve the issue of whether the arbitration clause at issue was unconscionable under New Jersey law. Accordingly, the Court's role in this case was not to make any factual determinations. Applying federal arbitration law, the Court determined that because the agreement contained numerous ambiguous provisions, it was for an arbitrator to interpret the ambiguities. Thus, for the purpose of answering the question posed by the Third Circuit, the Court "address[ed] how the ambiguous provisions, if interpreted and applied in a manner detrimental to Harris, could be unconscionable."

The Court first determined that the agreement's hearing-level cost provision, attorneys' fees provision and appeals cost provision were unconscionable because they could deter a litigant from pursuing her statutory rights, as well as bar her from an entitlement to fees to which she would otherwise be statutorily entitled if she prevailed.

As for the class-action waiver provision, the Court determined that, unlike *Muhammad*, the provision was not unconscionable. Essentially, the Court felt that Mrs. Harris was seeking damages in an amount sufficient to be an incentive to bring an individual claim.

The Court also determined that the foreclosure exclusion provision, while burdensome, was not unconscionable. The Court considered the unique judicial process of foreclosure actions, as well as the fact that attorneys' fees and costs would be available to Mrs. Harris in the foreclosure action if she successfully asserted her CFA defenses.

Finally, the Court determined that the unconscionable provisions could be severed from the remainder of the agreement.

Justice James Zazzali concurred in part and dissented in part. While he concurred with the Court's decision to hold various provisions unconscionable, he concluded that the foreclosure exclusion and class-action waiver provisions were also unconscionable, and that the objectionable provisions could not be severed, thus rendering the entire agreement unconscionable. Specifically, Justice Zazzali determined that the foreclosure exclusion provision was so burdensome that it effectively insulated the lender from damages, as most borrowers would not be inclined to defend foreclosure actions in court while pursuing affirmative claims through arbitration. As for the class-action waiver provision, Justice Zazzali concluded that Delta's business model was to seek out individuals in financial difficulties, those individuals being the precise type of persons who would benefit from class-action suits. Thus, the specific facts as they related to Mrs. Harris were irrelevant.

The foreclosure exclusion provision was so burdensome that it effectively insulated the lender from damages, as most borrowers would not be inclined to defend foreclosure actions in court while pursuing affirmative claims through arbitration.

Finally, Justice Rivera-Soto dissented once again. Without addressing the substance of the issues, he felt that because determinations of unconscionability are necessarily fact-sensitive, the Court's grant of certification of the question presented by the Third Circuit was "improvidently granted."

The final commercial case of interest did not involve language interpretation, and did involve a unanimous decision. "When a public contract is obtained by bribing a public official, the public entity is entitled to the gross profits obtained by the wrongdoer." So held the Court in *County of Essex v. First Union National Bank*, 186 N.J. 46 (2006). There, a bank official and a public employee entered into a kickback scheme whereby the public official received payoffs for securing municipal underwriting business from the public entity. Specifically, the bank underwrote three municipal bonds on behalf of the county, for which the public employee received a kickback for each transaction. Several years later, the SEC filed administrative proceedings against the bank. That matter settled when the bank agreed to disgorge more than $1.7 million into escrow for payments to injured parties.

Thereafter, the county filed the instant matter against the bank, the bank official, and the public employee. The trial court granted summary judgment on the bribery claims, and the matter proceeded to trial on the unjust enrichment/disgorgement, breach of fiduciary duty, Uniform Securities Law, and state RICO claims. At trial, the county argued it was entitled to disgorgement of the entire amount of fees generated by the kickback scheme. Evidence was adduced that the bank had earned more than $2.8 million in fees on the three bond transactions. However, the trial court placed the burden on the county to establish that the bank did not share any part of its fees with

innocent third parties. Because the county could meet its burden on only one of the transactions, the trial court instructed the jury that, if found liable, the bank had to disgorge profits on only that transaction, reasoning that lack of evidence on the allocation precluded disgorgement. The jury was also instructed that any disgorgement could be only for the amount of the fee retained by the bank.

The jury returned a verdict in favor of the county on the disgorgement issue in the amount of $600,000. The jury denied relief on the breach of fiduciary duty and Uniform Securities Law claims. It also determined that, although a claim had been established under the state RICO status, there was no loss. Although the county appealed this aspect of the verdict, the appellate panel found the issues insufficient to warrant discussion, and the issues were not addressed by the Supreme Court.

The judge awarded prejudgment interest from the date of the transaction. Both parties then appealed. The Appellate Division determined that the county was entitled to full disgorgement of the fees yielded by the two unallocated bond transactions, but affirmed the partial award for the shared transaction. As for prejudgment interest, the panel held that interest should run from the date the complaint was filed.

The Supreme Court had before it several issues pertaining to disgorgement, prejudgment interest, and punitive damages. First, the Court considered whether fee disgorgement was an appropriate remedy in the face of a valid contract between the parties. Relying on the maxim that a wrongdoer should not profit from his wrongdoing, the Court concluded that unjust enrichment/disgorgement was an appropriate and equitable basis of recovery. In so holding, the Court determined that the employee's illegal conduct was attributable to the bank, "which, absent disgorgement, would receive a benefit from the wrongful conduct of its employee committed in the scope of his employment." The bank had attempted to argue that the county waived its claim for disgorgement on the two unallocated transactions by conceding it had not suffered a loss, presumably because it would have proceeded with the financing in any event. The Court noted that the reasons for disgorgement are not related to whether the county suffered loss, but to eradicate the "evil of the wrongdoer retaining any of the fruits of its wrongful conduct."

The Court further held that the county was entitled to disgorgement of fees on all three transactions due to the bank official's unlawful conduct, and that the burden to establish allocation should have fallen on the bank, not the county. However, the Court affirmed the lower courts' rulings that the county was entitled to disgorgement of the allocated fees only on the portion of the fees retained by the bank.

As for the prejudgment interest award, the Court held that the county was entitled to interest from the date of the transactions. Unlike interest expressly governed by court rules, e.g., tort claims, the interest in this equitable claim was governed by equitable principles. Here, the bank had the benefit of the money from the date of each transaction.

Finally, the Court upheld the lower courts in determining that the county was not entitled to punitive damages because it had not suffered any loss under the fiduciary duty cause of action. ■