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Alternative Dispute Resolution

Arbitration Agreements in Long-Term Care

The impact of the Federal Arbitration Act and recent U.S. Supreme Court opinions

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In 2010, the New Jersey Superior Court, Appellate Division, issued its opinion in *Ruszala v. Brookdale Living Communities*, 1 A.3d 806 (N.J. Super 2010), holding that N.J.S.A. 30:13-8.1, which prohibited arbitration agreements, was pre-empted by the Federal Arbitration Act (FAA). It was groundbreaking in its scope, re-opening the path to arbitration as an instrument for the long-term care community to reduce costs and rein in the uncertainty inherent in jury verdicts. However, the *Ruszala* court also struck down several terms of the agreement as unconscionable. Recent opinions from the U.S. Supreme Court have reaffirmed the pre-emptive effect of the FAA, but have also raised questions about the *Ruszala* court's application of the unconscionability defense.

The N.J. Appellate Division: *Ruszala*

On Jan. 12, 2002, the Nursing Home Responsibilities and Rights of Residents Act was amended to include N.J.S.A. 30:13-8.1. The amendment declared void any predispute arbitration agreement between a patient and a nursing home or assisted living facility. This prohibition remained undisturbed until *Ruszala*.

Ruszala involved two consolidated appeals. In both cases, the plaintiff asserted a personal injury claim arising out of the care received at an assisted living facility. The two admission agreements contained identical arbitration and limitation of liability provisions. The agreements required that all claims, except eviction proceedings, be resolved through binding arbitration. The clauses further placed restrictions on discovery, capped compensatory damages and prohibited punitive damages. The defendants filed motions to compel arbitration, asserting that N.J.S.A. 30:13-8.1 was pre-empted by the FAA, which states that any agreement to arbitrate involving interstate commerce "*shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract*." 9 U.S.C.A. § 2 (emphasis added). After limited discovery, the trial court refused to enforce either arbitration agreement.

On appeal, the Appellate Division upheld the validity of the agreements, holding, in sum, that:

- Pursuant to the Commerce Clause of the United States Constitution, the FAA will apply to transactions "in individual cases without showing any specific effect upon interstate commerce, if in the aggregate the economic activity in question would represent a general practice subject to federal control." (Citing *Citizens Bank v. Alafabco*, 539 U.S. 52 (2003).)
- The facilities received some supplies from out of state; the companies were incorporated in foreign states; and they admitted residents that came from other states. These activities amounted to interstate commerce.
- The prohibition against arbitration agreements under N.J.S.A. 30:13-8.1 was irreconcilable with § 2 of the FAA and, therefore, pre-empted.

However, the court then voided specific portions of the arbitration agreement. Seizing upon the savings clause in § 2, the court noted that general contract law defenses, such as fraud, duress and unconscionability, may be invoked to invalidate an arbitration agreement without contravening § 2 of the FAA. The court determined that the agreements were contracts of adhesion and thus subject to a procedural and substantive unconscionability analysis. Finding that the former issue was underdeveloped in the record, the court turned its attention to substantive unconscionability. The court, relying

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upon *Rudbart v. North Jersey District Water Supply Commission*, 605 A.2d 681 (N.J. 1992), and *Muhammad v. County Bank of Rehoboth Beach*, 912 A.2d 88 (N.J. 2006), stated:

> The unconscionability issue in this matter centers on the limitations of discovery, the capping of compensatory damages to a seemingly arbitrary figure, and the outright prohibition of punitive damages. In determining whether these restrictions run counter to our state's public policy, we need look no further than to the plain language in N.J.S.A. § 30:13-8.1.
>
> When considered together, the restrictions on discovery, limits on compensatory damages, and outright prohibition on punitive damages form an unconscionable wall of protection for nursing home operators seeking to escape the full measure of accountability for tortious conduct that imperils a discrete group of vulnerable customers. This is precisely the evil the Legislature sought to enjoin by passing N.J.S.A. 30:13-8.1. We thus hold that these provisions in the arbitration clause of the residency agreement are void and unenforceable under the doctrine of substantive unconscionability.
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> As the Court did in *Muhammad*, the remedy here is to enforce our federal policy in favor of arbitration, while excising the unconscionable restrictions that we have concluded are unenforceable under NJSA Section 30:13-8.1.

Thus, while the court held that the FAA pre-empted N.J.S.A 30:13-8.1, it nevertheless relied heavily upon the public policy behind the New Jersey statute to void certain terms of the agreement as "unconscionable."

Subsequent opinions by the U.S. Supreme Court have cast doubt on that approach.

The U.S. Supreme Court: *Concepcion, Brown* and Their Progeny

Following *Ruszala*, the U.S. Supreme Court affirmed the supremacy of the FAA over inconsistent state law. However, the Court also addressed another question that impacts the holding in *Ruszala*: whether a court can rely upon the public policy behind the pre-empted state law when deciding issues of unconscionability. In a series of recent decisions, this nation's highest Court has suggested that such considerations no longer have a place in the analysis.

In *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the Concepcions purchased cell phone service that was advertised to include free phones. They were charged sales tax, which they contended violated the "free" promise. They instituted a class action against AT&T, which in turn moved to compel arbitration under the purchase agreement. The arbitration clause specifically waived class actions. The California Supreme Court had previously held that such waivers were unconscionable. The Court reasoned that since the potential recovery in each individual case is outweighed by the cost of litigation, "the waiver becomes, in practice, an exemption … from responsibility for [the company's] own fraud, or willful injury to the person or property of another."

The issue before the U.S. Supreme Court was whether the FAA pre-empts a state from conditioning enforcement of certain arbitration agreements on the availability of class-wide arbitration procedures. The Court held the state law was pre-empted.

In so holding, the Court set forth several principles to be followed when addressing unconscionability. The Court recognized that the savings clause in § 2 permits agreements to be invalidated by generally applicable contract defenses, such as fraud, duress and unconscionability. However, "the act cannot be held to destroy itself." Thus, a court may not rely upon defenses that apply only to arbitration or derive from a policy against arbitration, "for this would enable the court to effect what … the legislature cannot." This is a crucial point, as the liberal policy in favor of arbitration agreements, and the terms contained therein, would be thwarted if the agreements were voided by a state bias against such agreements.

To illustrate this point, the Court cited several examples, including limitations of discovery contained within an arbitration agreement, which a state court might incorrectly conclude were "unconscionable." The Court noted, "[s]uch examples are not fanciful, since the judicial hostility towards arbitration that prompted the FAA had manifested itself in a great variety of devices and formulas declaring arbitration against public policy."

As to the specific terms of an arbitration agreement, the Court stated that the FAA's objective is to afford "parties discretion in designing arbitration processes ... to allow for efficient, streamlined procedures tailored to the type of dispute." State rules may not compromise the principal purpose of the FAA, which is to ensure that private arbitration agreements are enforced according to their terms.

The effect of *Concepcion* was felt almost immediately in New Jersey jurisprudence. In *Litman v. Cellco Partnership*, the Third Circuit, relying upon *Concepcion*, held that New Jersey law forbidding class arbitration waivers as unconscionable was pre-empted by the FAA. 655 F.3d 225 (3rd Cir. 2011). In so holding, the Court noted that the *Muhammad* decision (which was relied upon by the *Ruszala* Court) was no longer applicable.

The significance of *Concepcion* and *Litman* is two-fold. First, when an anti-arbitration law is pre-empted by the FAA, the policy considerations behind the very same law cannot support a finding of unconscionability. Second, the terms of the arbitration agreement should be given deference under the FAA, especially where the purpose is an efficient, streamlined resolution of the dispute.

In *Marmet Health Care Center v. Brown*, 182 L.Ed. 2d 42 (2012), the Court again addressed the issues of pre-emption and unconscionability, this time in the context of nursing home arbitration

agreements. The litigation involved three separate personal injury actions filed against nursing homes in West Virginia, which were consolidated for purposes of appeal. In each case, a family member signed an admission agreement that included an arbitration clause. Under the West Virginia Nursing Home Act, all such arbitration clauses are deemed null and void. W.Va. Code 16-5C-15(c).

The West Virginia Supreme Court declared that Congress did not intend for the FAA to be applicable to personal injury or wrongful death suits. Thus, the Court concluded that the FAA did not pre-empt the state public policy against such predispute arbitration agreements. The Court had also proposed an "alternative" holding that the particular arbitration clauses were unconscionable and therefore void under the savings clause of 9 U.S.C. § 2.

In a firm rebuke, the U.S. Supreme Court rejected the state court's interpretation of the FAA as both incorrect and inconsistent with clear instruction and prior precedent of the Supreme Court. As to the alternative holding, the Court was unable to discern to what extent it was influenced by the pre-empted statute, stating:

> [T]he state court found the arbitration clauses unconscionable in part because a predispute arbitration agreement that applies to claims of personal injury or wrongful death against nursing homes "clearly violates public policy."
>
> On remand, the West Virginia court must consider whether, absent that general public policy, the arbitration clauses … are unenforceable under state common-law principles that are not specific to arbitration and preempted by the FAA.

In other words, the Court found that if the state law prohibition on arbitration is pre-empted by the FAA, the public policy behind the prohibition cannot be used to create an alternate path to voiding such agreements under the veil of "unconscionability."

Revisiting *Ruszala*

The *Concepcion* and *Brown* decisions raise an intriguing issue regarding the continued application of *Ruszala*. On one hand, the Court's holding that N.J.S.A. 30:13-8.1 is pre-empted by the FAA has been validated. On the other hand, the Court's reliance upon the public policy behind the pre-empted law to strike down various terms under the guise of unconscionability, has been called into question, all but inviting further scrutiny in the future.

These decisions also give rise to ancillary issues in the drafting of agreements, such as consideration in exchange for specific waivers and enhancing the concept of bargained-for-exchange. These issues require greater depth of discussion than can be provided here; perhaps another article for another day.

In summation, while the validity of arbitration agreements in long-term care has been resolved, the battle over the terms and limitations set forth in those agreements has just begun. Wielding the force of recent U.S. Supreme Court decisions, proponents of arbitration are sure to wage this fight with renewed vigor. ■