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▶ Courts Curtail the Application of the Consumer Fraud Act to "Consumer Transactions"

Michael O. Adelman and Justin C. Linder

The Consumer Fraud Act was originally enacted in 1960 to "combat 'sharp practices and dealings' that victimized consumers by luring them into purchases through fraudulent or deceptive means." Although the Act was originally intended to provide individual consumers with a strong remedy against "shifty, fast-talking and deceptive merchants," New Jersey courts have liberally interpreted the Act over the years, extending its breadth to a wide range of transactions involving commercial entities.

The lure of treble damages and attorneys fees has led counsel for both consumers and businesses to allege its application in connection with ever larger and more specialized transactions. Courts have applied the Act's provisions to transactions involving a vast array of goods and services, including pyramid schemes, the sale of wall panels for use in a condominium project and the sale of a crane to name just a few examples. Transactions between business entities have also been found to fall within the purview of the Act.

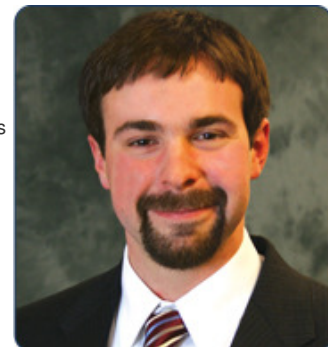
Although the scope of the CFA remains expansive, New Jersey courts have begun to rein in the substantive reach of the statute in recent years, using two approaches to do so. First, in 2004, the New Jersey Supreme Court effectively exempted "learned professionals" from liability under the Act when they are functioning in their professional capacities. The second approach, and the focus of this article, has been to limit the statute's definition of "merchandise" and to require plaintiffs to prove the undertaking at issue was a "consumer transaction."

The Act defines "merchandise" as any objects, wares, goods, commodities, services or anything offered, directly or indirectly to the public for sale. The touchstone for determining whether a good or service is "merchandise" for purposes of the Act is whether it is available for purchase by the general public.

Goods and services available for purchase by the general public may qualify as merchandise even if they are expensive, uncommon or suited to the needs of only a limited clientele. Computers designed to streamline traditional sales and record-keeping functions at retail stores, mass-marketed pyramid schemes, external wall panels and mass-produced yacht engines are examples of items that constitute merchandise under the Act.

In two recent decisions, New Jersey courts narrowed the boundaries of the Act's definition of "merchandise," holding that goods and services unavailable to the general public fall outside the scope of the Act.

In *Arc Networks, Inc. v. Gold Phone Card Co.*, a distributor of pre-paid phone cards brought a Consumer Fraud Act counterclaim against a business that provided it with telephone switching and other services on grounds that it wrongfully represented its capacity in violation of the Act. The Law Division held the Act inapplicable to the bulk telephone switching services purchased by the card distributor because these services "were not available to the general public" and "could only be accessed through the "800" numbers and PINs" provided to the phone card company's customers.



Similarly, in *South Broward Hospital District v. Medquist Inc.*, the United States District Court for the District of New Jersey held the Act inapplicable to a transaction involving the purchase of medical transcription services by a hospital. The court explained that there was "no indication that such medical transcription services are generally available to non-hospital entities" and that such services "[c]ertainly... cannot be thought of as a typical customer service."

In its seminal 2006 decision in *Papergraphics Int'l v. Correa*, the Appellate Division introduced an additional level of analysis for determining whether a particular transaction falls within the Act's aegis. Transcending the traditional inquiry as to whether there was "sale" of "merchandise," the *Papergraphics* court scrutinized whether the plaintiff's purchase of nearly 10,000 counterfeit ink cartridges for resale was in fact a "consumer transaction" as contemplated by the Act.

Exploring the Act's legislative history and original purpose, the court noted that although it contains no definition of "consumer" or "consumer transaction," the Act's clear statutory objective is the protection of consumers. The word "consumer" was initially interpreted by courts "in the context of '[its] ordinary meaning . . . in the market place,' affording protection to individual consumers."

Acknowledging that the Act is broadly applied to effectuate its remedial purposes and has been extended to corporate plaintiffs' "consumer oriented situation[s]", the Appellate Division nonetheless emphasized that the Act does not cover every sale in the marketplace. Rather, applicability of the Act "hinges on the nature of the transaction, requiring a case by case analysis." The court ultimately held that purchasers of merchandise for resale are not consumers within the meaning of the Act because they do not diminish or destroy the utility of the goods by their actions. Accordingly, the plaintiff's purchase of 9,714 printer ink cartridges for resale at a significant profit was not covered by the Act.

The most significant aspect of the *Papergraphics* decision was the Appellate Division's indication that the purchase of goods or services falling within the Act's definition of "merchandise" is insufficient, in and of itself, to invoke the Act's protection. To fall within the ambit of the Act, the purchaser of the merchandise must also be a "consumer" and the transaction must qualify as a "consumer transaction." Providing further guidance, the court noted that the parties' relative bargaining power is an important factor in the latter inquiry. A transaction that involves negotiations by two sophisticated parties with relatively equal bargaining power and industry knowledge is unlikely to fall within the ambit of the Act. The court also stressed that the Act is only intended to apply to purchases of goods and services for individual use by the consumer.

Two recent decisions applying the standard set forth in *Papergraphics* signal the recognition by courts of the Act's historic purpose and a shift away from expansive application of the Act.

In *Marco Polo Network Inc. v. ADP Financial Information Services, Inc.*, Judge Rachel Davidson declined to extend the Act to a transaction relating to the development of sophisticated trading platform software. The court held that the parties' engagement did not qualify as a consumer transaction and that the "highly specialized computer system" was not a consumer good.

Plaintiff Marco Polo Network was an entity created to implement an automated cross-border trading platform linking American and European markets with global emerging markets. After meeting with various competing vendors including IBM and Reuters, Marco Polo contracted with defendant Wilco Systems in 2002 to acquire software, equipment and services necessary to launch its trading platform. Marco Polo planned to market the trading platform to global brokers and asset managers.

Alleging that defendants made false and fraudulent representations concerning defendants' prior experience and its capacity to provide Marco Polo with the software platform, Marco Polo filed suit against defendants asserting, among other causes of action, a Consumer Fraud Act claim. In response, Wilco sought partial summary judgment dismissing the claim.

In its Brief in Opposition to Summary Judgment, Marco Polo contended that the undeveloped software that Wilco contracted to create fell within the Consumer Fraud Act's definition of merchandise because "businesses that purchase specialized and sophisticated products . . . demanded by a 'limited clientele'" are protected by the Act.

Relying on *Arc Networks* and *Papergraphics*, Judge Davidson concluded that the highly specialized computer system contracted for by Marco Polo did not qualify as a consumer good for purposes of the Act. Judge Davidson further noted that the parties' undertaking was not a consumer transaction because both parties were experienced commercial entities and the agreement resulted from negotiations between the parties.

In reaching her decision, Judge Davidson observed that the "Consumer Fraud Act was really intended to protect hapless consumers who were being exploited and the purpose of the treble damages was to provide an incentive for them to seek redress in the courts and to provide an incentive for attorneys to represent them."

Dismissing Marco Polo's Consumer Fraud Act claim, Judge Davidson indicated that a transaction does

not fall within the scope of the Act unless it involves a plaintiff who "was [an] unsophisticated buyer suffering a disparity of industry knowledge who was victimized after being lured into [the] purchase through the defendant's fraudulent, deceptive selling or advertising practices . . .".

In *Progressive Cleaning & Innovative Building Servs. v. Kennedy Funding, Inc.*, the United States District Court for the District of New Jersey held the Act inapplicable to a multi-million dollar commercial real estate financing transaction. In reaching its decision, the court looked to both the status of the parties and the nature of the transaction. Concluding that the loan was not a consumer transaction, Judge William J. Martini observed that plaintiff was not a first-time buyer of real estate, that both parties were experienced commercial entities with relatively equal bargaining power, and that the terms of the loan were negotiated by the parties prior to its execution.

The court also held the "hard money financing" at issue fell outside the Act's definition of "merchandise" because it was not a good or service "of the type sold to the general public." In reaching this conclusion, Judge Martini noted that the defendant's website marketed itself not as a standard commercial lender but as a company that provides "creative funding solutions." Accordingly, the funding bargained for by the plaintiff did not "qualify as the sale of credit in the 'popular sense.'"

These recent rulings demonstrate that New Jersey courts are unwilling to extend the Act's remedial provisions to purchases of merchandise for resale and to negotiated transactions between sophisticated entities for goods and services unavailable to the general public, hopefully portending a return to the conception of the consumer protection envisioned by the drafters of the Act. These holdings should also provide some comfort to entities that contract for reasonable limitations of liability in their commercial transactions.

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