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The New Jersey Consumer Fraud Act Has Limits In Commercial Transactions

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Yes, I know that it is called the New Jersey *Consumer* Fraud Act (the "CFA").[1] Notwithstanding the nomenclature, the CFA has been applied to business-to-business transactions. The result is predictable: plaintiffs in business-to-business disputes are adding CFA counts and stretching the intended use of the CFA in order to use the threat of the CFA's treble damages and fee-shifting provision to gain an advantage not envisioned by the parties. However, the Superior Court of New Jersey, Appellate Division's recent decision in *Princeton HealthCare System v. Netsmart New York, Inc*.,[2] limits the applicability of the CFA in business-to-business transactions.

The CFA is a powerful tool:

> The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby, is declared to be an unlawful practice … [3]

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Accordingly, any "person who suffers any ascertainable loss of money or property, real or personal, as a result of the use or employment by another person of any method, act or practice declared unlawful under" the CFA has a private cause of action.[4] The "hammer" is that a plaintiff who prevails under the CFA is entitled to treble damages and all reasonable attorney's fees.[5]

New Jersey enacted the CFA "to protect the consumer against imposition and loss as a result of fraud and fraudulent practices by persons engaged in the sale of goods and services."[6] However, the CFA defines a "person" as including "any natural person or his legal representative, partnership, corporation, company, trust, business entity or association."[7] Thus, New Jersey courts have held that under this broad definition of "person" a corporation may maintain an action for a violation of the CFA.[8] This has led courts outside of New Jersey to declare that New Jersey's CFA is designed to protect "commercial entities as well as traditional consumers from fraudulent or deceptive practices."[9] This is unlike New York, where commercial transactions are beyond the scope of its consumer protection laws.[10]

The CFA's application to business-to-business transactions creates unforeseen advantages and significant potential for abuse. As noted above, the CFA includes treble damages and fee shifting, which were not part of the agreement between the two commercial entities. Thus, one party to a business contract may take a garden-variety breach of contract or fraudulent inducement claim, assert that it is based on a misrepresentation or concealment and put forward a CFA claim. Because this claim may well withstand a motion to dismiss, the plaintiff will now have strong leverage – the threat of treble damages and significant attorneys' fees – for settlement negotiations, a leverage that was not part of the original negotiations between the business parties.

The Appellate Division has now held that certain commercial transactions may be beyond the purview of the CFA and thus subject to a motion to dismiss (or a

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summary judgment motion after limited discovery). In *Princeton HealthCare*, the plaintiff (PHCS) was a nonprofit corporation providing healthcare services, while the defendant (Netsmart) provided computer software products and services to healthcare facilities. PHCS distributed a "request for proposals" for a "Behavioral Health Information System," containing detailed specifications any proposal was required to meet and an outline of PHCS's criteria for selecting a company for the project. Netsmart submitted a 149-page response, and other companies also responded to the request. As the court found, PHCS "subsequently engaged in a lengthy process of evaluation of these responses." The parties met and engaged in negotiations for over two years, and PHCS then selected Netsmart to provide the system, with the parties entering into a written contract.[11]

There were substantial delays in Netsmart's implementation of the system, with each side claiming the other was responsible for the delays. PHCS asserted that Netsmart was in default of its obligation and terminated the contract. PHCS then sued, alleging breach of contract, violation of the covenant of good faith and fair dealing, rescission based on Netsmart's alleged fraud in inducing PHCS to enter into the contract and violation of the CFA. The trial court expressly held that PHCS could maintain its CFA claim.[12]

The Appellate Division reversed and dismissed the CFA claim. While recognizing that prior rulings permitted business-to-business CFA claims, the court held that "this does not mean that every contract entered into by a corporation may be the subject of a CFA claim."[13] The court held that the CFA applies to "sales of merchandise," which is defined to include "any objects, wares, goals, commodities, services or anything offered, directly or indirectly *to the public* for sale."[14] The Appellate Division limited the phrase "to the public" to mean "the public at large."[15]

The court concluded that the "contract between [PHCS] and Netsmart for the installation and implementation of a complex computer system at Princeton House did not constitute a simple purchase of computer software sold to the public at large." The court identified that the contract arose from a request for proposals prepared by PHCS with the help of a consultant, and that PHCS engaged in two years of evaluations and negotiations before entering into a contract. Moreover, the "contract did not provide for simply the installation of a standardized computer software program but rather the design of a custom-made program to satisfy [PHCS's] unique needs and Netsmart's active participation in implementation of this program." The court emphatically held that "[t]his kind of heavily negotiated contract between two sophisticated corporate entities does not constitute a 'sale of merchandise' within the intent of the CFA."[16]

"[B]usiness parties engaged in a commercial dispute should not automatically assume that the CFA will apply to a standard breach of contract or fraudulent inducement situation. Rather, where the parties are 'sophisticated corporate entities' that engaged in a 'heavy' negotiation for something that is not a 'simple purchase,' the defendant(s) should move quickly to dismiss the CFA claims."

In sum, business parties engaged in a commercial dispute should not automatically assume that the CFA will apply to a standard breach of contract or fraudulent inducement situation. Rather, where the parties are "sophisticated corporate entities" that engaged in a "heavy" negotiation for something that is not a "simple purchase," the defendant(s) should move quickly to dismiss the CFA claims. If granted, this will put the parties back on a level playing field – i.e., without the sword of treble damages and attorneys' fees hanging over the defendant's head – so that the case can proceed in accordance with well-established principles of breach of contract and common law fraud. Indeed, without the windfall of treble damages and fee shifting, the parties may be more inclined to reach a business understanding rather than engaging in full-throttle litigation, thereby saving the parties attorneys' fees and uncertainty and allowing businesses to do what they do best: engage in business.

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1 N.J.S.A. §§ 56:8-1 to 56:8-20.

2 2011 N.J. Super. LEXIS 190, Docket No. A-3533-10T4 (Oct. 21, 2011).

3 N.J.S.A. § 56:8-2.

4 N.J.S.A. § 56:8-19.

5 *Id.*

6 *Scibek v. Longette*, 339 N.J. Super. 72, 77 (App. Div. 2001) (citation omitted).

7 N.J.S.A. § 56:8-1(d).

8 *See, e.g., Coastal Group, Inc., v. Dryvit Systems, Inc.*, 274 N.J. Super. 171, 179-180 (App. Div. 1994); *Perth Amboy Iron Works, Inc. v. American Home Assurance Co.*, 226 N.J. Super. 200, 209 n. 7 (App. Div. 1988), *aff'd*, 118 N.J. 249 (1990); *Hundred E. Credit Corp. v. Eric Schuster Corp.*, 212 N.J. Super. 350, 354-357 (App. Div. 1986), *cert. denied*, 107 N.J. 60 (1986).

9 *Fresh Start Industries, Inc. v. ATX Telecommunications,* 295 F. Supp. 2d 521, 527 (E.D. Pa. 2003).

10 *See Stutman v. Chemical Bank*, 95 N.Y.2d 24, 29 (N.Y. 2000) ("A plaintiff under [General Business Law] section 349 must prove three elements: first, that the challenged act or practice was consumer-oriented…."); *Wells Fargo Bank Northwest N.A. v. Taca Int'l Airlines*, 247 F. Supp. 2d 352, 371 (S.D.N.Y. 2002) (stating that the statute is for consumer transactions and, at best, it applies to business dealings only if the "deceptions perpetrated … affect the public.").

11 2011 N.J. Super. LEXIS 190 at *2-4.

12 *Id.* at *4-5.

13 *Id.* at *9.

14 *Id.* at *9. (emphasis in original).

15 *Id.* at *9-10.

16 *Id.* at *10-11.