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Legal Briefs

Court Rejects Damages Expert's Claims for Breach of Contract and Unjust Enrichment

The New Jersey District Court recently ruled that an economic damages expert retained by plaintiffs' counsel in a class action was not entitled to any further compensation for his work. The facts in *Rothstein v. Harstad* (September 30, 2014) are a virtual catalogue of what an expert witness should ***not*** do when rendering professional services.

Ronald Harstad, a professor of economics at the University of Missouri, was retained by plaintiffs' counsel to perform damages calculations as an expert in a class action lawsuit involving alleged misrepresentations in the sale and marketing of prepaid calling cards. In May 2006, Harstad sent a letter outlining the terms of his engagement, including his hourly rate compensation, his agreement to furnish monthly logs detailing the daily time expenditure, his commitment to use lower rate graduate and undergraduate students to perform appropriate services, and his agreement to accept payment for each invoice over time. By April 2008 plaintiffs' counsel had furnished Harstad with all of the underlying data and information he needed to perform the damage calculations. Harstad then estimated the cost of making the necessary calculations would be $17,000 - $21,000. Plaintiffs' counsel relied on Harstad's estimate in proceeding to have him serve as their expert.

Despite his estimate, Harstad billed and was paid $164,604.79 by September 2008. And, despite his agreement to render monthly logs of his time, Harstad did not submit any invoices for October and November 2008 until December 2008, when he sent an invoice totaling an additional $110,700. That invoice was followed by a December 29th invoice for $50,100. In January 2009, plaintiffs' counsel objected to those invoices. In response, Harstad instructed plaintiffs' counsel that, unless the outstanding invoices were paid immediately, they were not to use any of the reports or analyses he had provided since October 2008. Plaintiffs' counsel chose to reject Harstad's work and engage another expert. That new expert was able to complete the damage calculations for $22,500, using the same information that had been provided to Harstad .

Plaintiffs' counsel then filed a declaratory judgment action to establish that they owed no further amounts to Harstad. Harstad counterclaimed for breach of contract and unjust enrichment and sought $410,000 in damages. After a non-jury trial before then Magistrate Judge (now district judge) Madeline Cox Arleo, the court found that Harstad was not entitled to any further compensation or damages.

First, the court noted that Harstad had failed to comply with the terms of his own agreement, failing to submit monthly logs (only 13 "haphazard invoices" over the 28 months he was retained) and failing to use lower paid students for appropriate tasks. As one example, the court pointed out that Harstad had billed at $600 per hour for tasks such as mailing CDs via Federal Express, burning CDs, and evaluating his own billing errors. The court also cited a number of billing errors, including an invoice for 28.4 hours when only 7.3 hours were listed on the invoice, and Harstad's double –billing of 12.6 hours on other invoices. Providing the court with even less confidence in his billing methods, Harstad testified that the underlying information on his invoices came from entries he had made on Post-It notes that he had since discarded. Harstad also admitted that he had not adjusted his billings for the time he spent correcting these billing mistakes.

Second, the court was persuaded that Harstad did not deserve further compensation, given that he had already received an amount far exceeding his original estimate for work that was ultimately performed by another expert for the amount of Harstad's original estimate. The court found that Harstad had a duty to update plaintiffs' counsel as his costs increased but failed to do so in breach of his duty of good faith and fair dealing. The court also took pains to note that Harstad's work product was "plagued with his own mathematical errors," noting that his initial damages estimate was subsequently corrected to a figure more than $4,000,000 lower, and that figure was lowered by another $35 million after a paralegal working for plaintiffs' counsel pointed out that Harstad had multiplied by the wrong column in Excel. All of this led the court to conclude that Harstad had breached his agreement to provide what he had promised —"a defensible damages estimate."

Third, because Harstad had chosen to rescind his agreement, demanding that plaintiffs' counsel not use his work product, and plaintiffs' counsel had accepted that alternative, the court held that Harstad could no longer sue to recover damages for breach of the contract. Judge Arleo noted that rescission and damages were alternative and inconsistent remedies, noting that Harstad had rejected the option of allowing plaintiffs' counsel to use his work and later suing for damages. Harstad had also breached the implied covenant of good faith and fair dealing by not living up to his own contractual obligations even though he knew plaintiffs' counsel were relying on his promised performance.

The *Rothstein* decision should remind experts of the potentially disastrous consequences of laxity and sloppiness in invoices, disregard of essential terms of the engagement, and failure to check that work product is free from mathematical errors. The reputational damage is all the more severe when those defects are highlighted in a judicial decision. Adversary counsel will inevitably now confront Professor Harstad with Judge Arleo's opinion, and the widely accessible opinion may limit his potential engagement opportunities.

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The Legality Of "Kye" Loans

A "Kye" (pronounced "keh") is a rotating credit association common among Korean immigrant communities. Members of the Kye contribute a fixed amount on a regular basis, and each member then receives the "pot" on a rotating basis until all members have received it. The Kye's origins are said to date back to sixteenth century Korean farming villages as a means of raising capital for those that would not otherwise have access to loans. A recent case considered whether a Kye was enforceable or against public policy. *Hea Sook Han v. Cindy E. Jang*, No. BER-L-6208-11 (N.J. Super. Ct., July 31, 2014).

In *Han*, the Kye was comprised of 26 members split into two groups of 13, each with a "leader." The plaintiff was in the group led by Khang and the defendant was in the group led by Kim. Each member gave their respective leader $3,000 each month to deposit in the Kye and each month a member would receive a payout of $72,000. The members' identities, contributions and payments, and dates of payment were recorded by the leaders into a "Kye chart," which was written in Korean. Upon dissolution, the Kye was required to reimburse investments of members who did not receive a payout. In order to accomplish that, the Kye required members who received a $72,000 payout to return the amount of money they received in excess of the amount of their investment.

The dispute in this case arose when the Kye dissolved after Khang's members did not make their monthly payments, leaving plaintiff to be reimbursed for the net amount of $42,000. Defendant Jang was instructed to sign 14 checks in the amount of $3,000 each with the payee line blank so that her leader (Kim) could reimburse those members who did not receive a payout. These checks were given to the plaintiff Han. Plaintiff testified that her son went to the defendant's jewelry store and exchanged one check for $3,000 in cash. Thereafter plaintiff went to the store and received $13,000 worth of jewelry, which she claimed was to secure payment on the remaining checks. The defendant Jang testified differently: that she gave plaintiff the jewelry in return for plaintiff's agreement to return the remaining checks. When plaintiff did not return the remaining checks, Jang stopped payment. As a result, plaintiff Han filed a complaint for breach of contract for $39,000 and Jang counterclaimed for the value of the jewelry.

Defendant Jang requested a jury charge that the alleged contract was unenforceable because the Kye violated law and public policy. Jang alleged that the Kye violated, among other laws, 26 C.F.R.§ 1.60501 (requiring a report of any receipt of cash in excess of $10,000); the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 to -76 (requiring registration of securities); the New Jersey State Tax Uniform Procedures Law, N.J.S.A. 54:48-1 to -7 (imposing penalties for certain transactions); and N.J.S.A. 17:16A-2 (establishing registration requirements for investment companies). Defendant also argued that the Kye offered outrageously high interest rates and members did not report the interest as income.

The trial judge declined to give the illegality charge, reasoning that whether or not the Kye itself was illegal was irrelevant because the parties' contract was separate and distinct from the Kye. The jury found that the plaintiff had established an enforceable contract and the defendant had breached it, and awarded $39,000 (13 checks at $3,000 per check). The jury also found for Jang on her counterclaim for $13,000 (the jewelry given to Han). Accordingly, a judgment was returned in favor of plaintiff in the amount of $26,000.

On appeal, the Appellate Division held that the trial court should have decided whether or not the Kye was illegal or unenforceable as against public policy, law and regulations. The Appellate Division then remanded the case to the trial court to make that determination.

On remand, the trial court did not find any merit in defendant's argument. Noting that the defendant produced no authority showing that any Kye transaction had been declared illegal by any court, the court upheld the Kye as legal and enforceable:

> The Kye reflects a cornerstone of the Korean community in which the established members of the community make private loans to new members. While this particular Kye differed by referring to itself as an investment club, the purpose remained the same. The Kye was a private agreement to pool funds to be lent to borrowers for legitimate business purposes. The defendant's contention that some of the members may not have properly accounted for the income from the Kye on their tax returns is a collateral issue that does not affect the validity of the Kye. Similarly, failure to register with a government agency does not make the contract unenforceable. The defendant has been unable to overcome the presumption that the Kye was legal. Slip op. at 8.

Ultimately, the court concluded that the contract that governed the Kye did not have, at its heart, any illegal purpose and that "[a]ny ancillary regulation or failures that might have violated tax laws were not the subject matter of the Kye." The court refused to invalidate a contract the jury found to exist between the plaintiff and defendant because the defendant claimed that "ancillary aspects of the Kye may have theoretically violated tax and regulatory statutes."

By affirming the legal validity of Kye transactions, *Han* offers common law protection for these traditional Korean financial arrangements.

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Second Circuit Finds Entry-Level Accountants Exempt From FLSA Overtime

The U.S. Court of Appeals for the Second Circuit has ruled that entry level accountants seeking unpaid overtime under the Fair Labor Standards Act (FLSA) are exempt from FLSA's overtime requirements because they fall within the statutory exemption for "learned professionals." *Pippins v. KPMG LLP*, Docket No. 13-990-cv (2nd Cir. July 22, 2014).

Several former KPMG employees who had been employed as "Audit Associates" brought the lawsuit claiming that they regularly worked more than 40 hours per week, yet did not receive overtime pay as required by FLSA. KPMG argued that the plaintiffs met the exemption in 29 C.F.R §541.301 because they worked as accountants, one of the specified learned professions identified in the regulations as "a field of science or learning." The statutory test qualified employees for the exemption if their work was (1) predominantly intellectual in character and required the consistent exercise of discretion and judgment, (2) in a field of science or learning, which includes accounting, and (3) a type that entailed "specialized academic training as a standard prerequisite for entrance into the profession."

The plaintiffs contended that Audit Associates were the most junior members of engagement teams, that they received instruction and training through KPMG itself, and not specialized academic training, and they primarily performed low-level routine work, rather than work that involved specialized knowledge or professional discretion. As Audit Associates, their typical duties consisted of inventory observation (the counting, recording, and checking of client's physical inventory), walkthroughs (reviews with clients of the clients' procedures for financial reporting), and preparation of work papers (documents which enumerate the audit process and review client controls). The plaintiffs contended that they fit within the non-exempt regulatory category of "accounting clerks, bookkeepers, and other employees who normally perform a great deal of routine work." 29 C.F.R. §541.301(e)(5).

The Court of Appeals upheld the trial court's determination, disagreeing with what it termed "the plaintiffs' trivializing characterization of their work." Slip op. at 25. "Breaking down tasks into their component parts so that they can be described in the most banal way possible obscures the judgment called for in determining if workers are learned professionals." Id. at 28. The court noted that Audit Associates, even as the most junior members of an audit team, were required to apply "appropriate professional skepticism . . . an attitude that includes a questioning mind and a critical assessment of audit evidence" (id. at 21) and that the "tasks performed by Audit Associates are the quintessential activities that form the basis for an audit opinion" (id. at 28), qualities that were the essence of the accounting profession. The court further noted that the requirement for "specialized academic training" was met because Audit Associates were generally required to be eligible to become licensed as Certified Public Accountants, and that the vast majority of Audit Associates had accounting degrees.

The court thus firmly rejected the plaintiffs' attempt to turn FLSA from "a shield to protect unwary workers" into "a sword by which [professionals] at the pinnacle of accomplishment and prestige in [their profession] may obtain a benefit from their employer for which they did not bargain." Id. at 43.

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New Jersey Supreme Court Recognizes Common Interest Doctrine Protects Shared Information

In *O'Boyle v. Borough of Longport*, 218 N.J. 168 (July 21, 2014), the New Jersey Supreme Court recognized the common interest doctrine, which protects attorney-client communications and attorney work product materials shared outside of the attorney-client relationship with a party having a common interest. Those kinds of communications often occur among attorneys who are defending against common claims—as were the municipal attorney who had defended against civil lawsuits brought by *O'Boyle* and the private attorney representing several municipal officials sued by *O'Boyle*. Other typical circumstances include communications between the attorney for a party defendant and the attorney for its liability insurance carrier or indemnitor.

The Supreme Court reasoned that protection of information shared under such circumstances "permit[s] the free flow of information between or among counsel who represent clients with a commonality of purpose" and "offers all parties to the exchange the real possibility for better representation by making more information available to craft a position and inform decision-making in anticipation of or in the course of litigation." *O'Boyle*, 218 N.J. at 197. Until *O'Boyle*, those who sought to invoke the common interest protection over such shared material had to rely on a 2001 Appellate Division case, *LaPorta v. Gloucester Cnty. Bd. of Chosen Freeholders*, 340 N.J. Super. 254 (App. Div. 2001). Under the standards announced in *O'Boyle*, the common interest doctrine will protect the disclosure of information as long as:

> (1) The disclosure was made in connection with actual or anticipated litigation. The disclosure may be for the purpose of considering whether participate in a common interest arrangement.
>
> (2) The parties share a common purpose with respect to the actual or anticipated litigation, but the parties need not have an identical interest and need not even be involved in the same litigated matter.
>
> (3) The disclosure is made in a manner intended to preserve the confidential nature of the shared material. Thus, attorney-client privileged information or work product material may be made to an attorney for another party who shares in the common purpose.

Despite these standards, it is open to question whether, on different facts, the court's decision would have been even broader. Although *O'Boyle* relied on the *Restatement (Third) of the Law Governing Lawyers* §76(1)(2000), the decision does not go as far as the *Restatement*, which recognizes the common interest doctrine even in non-litigation contexts and even among clients. The court was not presented with a non-litigation scenario in *O'Boyle* so it is possible that the court could expand the common interest doctrine in such circumstances. In addition, *O'Boyle* limits the common interest protection to communications shared among attorneys. Other jurisdictions have divided over whether to protect common interest communications that are shared among clients. When and if the court is presented with a different set of facts, it may well conclude that the rationales supporting the common interest doctrine justify expanding the doctrine to those circumstances.

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New Jersey Court Casts Doubt on Enforceability of Consumer Arbitration Agreements That Lack "Magic Words"

The New Jersey Supreme Court recently cast doubt on the enforceability of arbitration clauses in consumer agreements that lack "magic words" specifying that consumers have waived their rights to litigate claims in a court. *Atalese v. U.S. Legal Services Group*, *L.P.*, 2014 WL 4689318 (N.J. Sept. 23, 2014). Any company doing business in New Jersey that uses an arbitration clause in its contracts – consumer or otherwise – should immediately review the clause to ensure it passes muster under *Atalese*.

The plaintiff in *Atalese* contracted with U.S. Legal Services Group (USLSG) for debt adjustment services. The plaintiff filed suit in state court, alleging that USLSG violated two state consumer protection statutes by misrepresenting the scope of the services it would provide and its status as a licensed debt adjuster in New Jersey.

USLSG moved to compel arbitration, based on an arbitration clause in the parties' agreement, which provided:

Arbitration: In the event of any claim or dispute between Client and the USLSG related to this Agreement or related to any performance of any services related to this Agreement, the claim or dispute shall be submitted to binding arbitration upon the request of either party upon the service of that request on the other party. The parties shall agree on a single arbitrator to resolve the dispute. . . . Any decision of the arbitrator shall be final and may be entered into any judgment in any court of competent jurisdiction.

The trial court granted USLSG's motion to compel arbitration, and the Appellate Division affirmed. In a unanimous decision, the New Jersey Supreme Court reversed, and held that the arbitration clause was unenforceable because it "did not clearly and unambiguously signal to plaintiff that she was surrendering her right to pursue her statutory claims in court."

The court acknowledged that federal law "requires courts to place arbitration agreements on an equal footing with other contracts and enforce them according to their terms." But the court insisted it was not singling out arbitration agreements for more burdensome treatment, reasoning that any contractual waiver of rights "must be clearly and unmistakably established."

The court criticized the arbitration clause at issue for not "explain[ing] what arbitration is," how it "is different from a proceeding in a court of law," and for not being "written in plain language that would be clear and understandable to the average consumer." Indeed, the court rejected the argument that consumers are sophisticated enough to understand that by agreeing to resolve disputes in binding arbitration means they are forgoing the right to have the disputes resolved in court.

The court stressed that "no prescribed set of words" are required. But some "clear and unambiguous" language, which in a "general and sufficiently broad way, must explain that the plaintiff is giving up her right to bring her claims in court or have a jury resolve the dispute" is necessary in order for consumer arbitration clauses to be enforceable.

In the short term, consumer class action filings in New Jersey state court will increase as plaintiffs' class action lawyers will likely attempt to exploit *Atalese* and negate existing consumer arbitration provisions that typically require claims to be pursued on an individual basis, rather than as part of a class action. Removal of such actions to federal court will be a key strategy, because in federal court litigants can still argue that *Atalese* should not be followed because it is trumped by the Federal Arbitration Act and recent U.S. Supreme Court precedent, such as *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) and *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013).

In the long term, *Atalese* will remain binding law in New Jersey state court absent review and reversal by the U.S. Supreme Court. It is foreseeable the plaintiffs' bar will attempt to extend *Atalese* to other types of arbitration agreements, such as those in employment agreements or commercial contracts. As a result, any company doing business in New Jersey that uses an arbitration clause in any type of agreement should carefully review the clause to ensure it unambiguously explains the difference between litigation and arbitration, and makes clear that litigants are foreclosed from having disputes resolved in court.

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Professional License Applications Can Be Denied Based on Unintentional Errors

A recent opinion issued by the Appellate Division confirmed that professionals in New Jersey can be denied licenses simply due to application errors even if the applicant did not have the intent to deceive.

The case at issue is *In the Matter of the Application of Y.L.* Here, the applicant was denied her license by the state Board of Massage and Bodywork Therapy because she failed to disclose that she had been arrested for prostitution in 2004. The Board claimed that Y.L. engaged in misrepresentation by failing to disclose the prostitution arrest in response to a question asking whether the applicant had ever been arrested for any crime or offense. Y.L.'s application included an affidavit stating: "[a]ll information provided in connection with this application is true to the best of my knowledge and belief. I understand that any omissions, inaccuracies or failure to make full disclosure may be deemed sufficient to deny licensure." Y.L. appealed the Board's denial, arguing that the Board must find that she had an intent to deceive in order to deny her license application.

The Appellate Division disagreed and affirmed the Board's denial. The court reasoned that "negligent misrepresentation is a legally sound concept. An incorrect statement, negligently made and justifiably relied upon, may be the basis of recovery of damages for economic loss or injury sustained as a consequence of that reliance." Accordingly, the court concluded that even if the court accepted her explanation for failure to reveal her arrest (her limited ability to understand English), the mistake constituted at least negligent misrepresentation.

The court cited a 2013 appellate decision that upheld the denial of a pharmacy's application to participate in the state's Medicare program because of its unintentional failure to disclose the criminal record of one of its employees. In that case, *Township Pharmacy v. Division of Medical Assistance and Health Services*, the court found that the nondisclosure of the criminal record justified exclusion from the program under a state regulation that listed "submission of a false or fraudulent application" as a basis for disqualification. The court noted that the pharmacy had certified the accuracy of the application, just as Y.L. had signed an affidavit stating that all information provided was "true to the best of my knowledge and belief" and that she understood that "any omissions, inaccuracies or failure to make full disclosure may be deemed sufficient to deny licensure."

Because most professional license applications include a similar certification or are otherwise made under oath, any errors, inaccuracies or omissions may be deemed grounds for disqualification. Thus, Y.L. is a reminder to be meticulous in responding to all requested information, and that it is better to disclose and explain negative information than to conceal or omit it.

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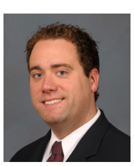

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