

NJ Supreme Court Decision Concerning Spill Act Arbitration Creates Serious Questions About Standards Used to Appeal All Arbitration Awards Going Forward

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On July 29, 2019, the New Jersey Supreme Court rendered its decision in *US Masters Residential Property (USA) Fund v. New Jersey Department of Environmental Protection*. Although the Court's ruling overturned the decision of a statutory arbitration for compensation under New Jersey's Spill Compensation and Control Act (Spill Act) on substantive and factual grounds, the decision raises some concerns, in that it may unnecessarily complicate litigation over civil arbitration awards under both the New Jersey Arbitration Act and the Federal Arbitration Act in general.

The 4-to-3 decision rendered by the Hon. Justice LaVecchia in *US Masters* is unusual under New Jersey law when arbitrations are at issue, but may well be limited to the unique circumstances of a Spill Act arbitration. Still, it is important to note that the arbitration process and decision effectively serves under both Spill Act and NJDEP regulations as the "final agency decision" even though the agency does not formally affirm or deny the arbitration decision, thus leaving the decision open to review by the Appellate Division and ultimately the Supreme Court. However, as Justice LaVecchia failed to clearly specify that her decision was explicitly limited to a Spill Act arbitration, there is a chance the decision may have broader consequences, as it is possible that some counsel will attempt to use it to challenge non-Spill Act arbitration awards in other litigations.

Background of the Case

The Spill Act was created as a statutory means to provide compensation for environmental contamination resulting from the discharge of hazardous substances. In this case, US Masters claimed that its property

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was damaged by floodwaters containing petroleum based toxins that had emanated from a contiguous property as a result of Superstorm Sandy. The NJDEP denied the claim on the basis that there was no sufficient expert opinion proving that the petroleum substance had come from Superstorm Sandy, as opposed to "historic fill." However, because the arbitrator apparently accepted a late expert report from the State alleging this theory, but refused to accept a rebuttal report from US Masters, the factual basis for the arbitrator's decision was in question.

In February 2014, US Masters initiated administrative arbitration proceedings pursuant to NJDEP regulations. Following extensive delays, the arbitration was scheduled for February 2016, some two years later. Notwithstanding the delays, the NJDEP did not serve the expert report of Dr. Dennis Stainken until mid-January 2016. The report contained previously unarticulated details to support the denial of the claim by the NJDEP, however the arbitrator refused to allow US Masters to file a rebuttal report or present evidence challenging the State's expert.

US Masters moved to exclude the report on the basis of lateness, which the arbitrator denied. The arbitrator further refused to provide US Masters the right to rebut the report with responsive factual and expert material.

In April 2016, the arbitrator denied the Spill Act claim. US Masters first sought relief in the Appellate Division which was denied, and the Supreme Court accepted its application for Certification.

Supreme Court Ruling

The Supreme Court acknowledged that a review of an arbitrator's decision is generally limited, but noted that in the Spill Fund context, the "administrative decision" results remain reviewable for "fundamental fairness" and to ensure that the ultimate decision is not inconsistent with the evidence presented and remedial purposes of the Spill Act. Justice LaVecchia further noted: "We have concerns about this proceeding. Although we are mindful of the deferential standard of review, flaws in the substantive reasoning of the arbitration decision as well as procedural fairness considerations undermine confidence in the outcome of this arbitration enough to persuade us, in the interest of fairness, to require that a new arbitration be conducted."

The Court identified two significant substantive and procedural deficiencies in the arbitration that merited a new arbitration. First, the arbitrator mischaracterized the expert testimony to find expert support for the proposition that the oily substance had settled on the bottom of nearby waterways and was churned up by Superstorm Sandy. The Court found that the arbitrator's erroneous perception of the facts in the record based on the defendant's late expert report rendered the agency's decision "arbitrary and capricious" and therefore infirm. Second, the Court found that the arbitrator's decision to bar US Masters from presenting evidence to rebut the NJDEP's late expert report further raised fundamental "due process" and fairness concerns sufficient to reverse the award.

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In its decision, the Court makes reference to the typically deferential standard of review applicable to arbitration decisions. Generally, under the New Jersey Arbitration Act and the Federal Arbitration Act, arbitration awards may only be overturned on the basis of bias, fraud, corruption, or “undue means.” Although none of these bases was applied in this case, the arbitration award was still overturned.

The Supreme Court has faced similar issues in earlier cases. In *Perini v. Great Bay Hotel and Casino*, the Court determined in 1992 that undue means could encompass “egregious errors of law” by an arbitrator, paving the way for countless appeals. The Court reversed itself two years later in *Tretina Printing v. Fitzpatrick and Associates*, overturning its own ruling that a mistake of law or fact was sufficient to overturn an arbitration award, and stating that only misconduct by the arbitrator could effectively be used to overturn an arbitration award.

In *US Masters*, it appears that the Court may have taken a step back through the *Perini* door. While Justice LaVecchia’s decision may not have been as explicit as it should have been, it is important to note that the New Jersey Arbitration Act and the Federal Arbitration Act generally apply to agreements to arbitrate entered into by parties. Those statutes clearly provide that an arbitration decision may not be overturned due to a mistake of fact or law by an arbitrator or arbitration panel. *US Masters* involved a public agency arbitration that becomes, in effect, the final agency decision on the action. The law provides that judicial review of the arbitration decision is direct to the Appellate Division like any other final agency decision. Thus, the Supreme Court noted in *US Masters* that such agency decisions are reviewed pursuant to the “arbitrary and capricious” standard, and that this decision based on erroneous and unsupported facts and expert findings, was, in fact, both arbitrary and capricious.

What makes the decision in the *US Masters* case interesting is that although at first blush the Court’s ruling does not generally apply to all arbitration matters, Justice LaVecchia’s reference to arbitration in the latter part of her decision, coupled with her failure to explicitly limit her decision to Spill Act cases, may have opened the door to apply the rationales expressed in *US Masters* to non-Spill Act arbitration cases.

Please contact the author of this Alert, **Alan S. Pralgever**, with questions or for additional information.