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Unilateral Arbitration Provisions in Consumer Mortgage Loans Upheld

by Evan C. Pappas

The Supreme Court of Pennsylvania, in *Salley v. Option One Mortgage Corp.*, recently upheld a mortgage company's right to enforce a "one-sided" arbitration provision in a loan agreement with a consumer. The agreement in question required the borrower to proceed with any claim against the mortgage company through arbitration while allowing the mortgage company to bring suit against the borrower in state or federal court. The effect of *Salley* has been to vindicate the use of such non-reciprocal provisions in Pennsylvania consumer mortgage loan agreements.

The borrower, Will Salley, Jr., brought a lawsuit in federal court against Option One based in part on the federal Truth-in-Lending Act and Pennsylvania's Unfair Trade Practices and Consumer Protection Law. Mr. Salley sought rescission of the loan, termination of any security interest created in his property, return of all money he paid in connection with the transaction, statutory damages and attorney fees. Option One defended against the lawsuit maintaining that under the loan documents, Mr. Salley had waived his right to file suit in federal court. Option One argued that the parties' contract required Mr. Salley to bring his claims against Option One through arbitration.

The court first recognized that the Federal Arbitration Act creates a strong presumption in favor of upholding arbitration provisions that are agreed upon by the parties. Specifically, the statute provides that unless grounds exist for revoking such an agreement, a written provision in any contract to settle by arbitration a controversy arising out of the contract is valid, irrevocable and enforceable. Pennsylvania has an almost identical statute. The court recognized, however, that ordinary contract law defenses such as fraud, duress and unconscionability may constitute grounds for not enforcing a contractual arbitration provision.

Mr. Salley sought to have the arbitration provision in his contract declared invalid on the grounds that it was unconscionable. His argument relied on the Pennsylvania Superior Court's decision in *Lytle v. Citifinancial Services*, which held that the reservation by Citifinancial of a right of access to the courts for itself to the exclusion of such right in the consumer creates a presumption of unconscionability. Unless such presumption is successfully rebutted, the arbitration provision is rendered invalid, permitting access by the consumer to the courts.

Prior to the decision in *Salley*, the *Lytle* holding was in conflict with a case decided by the federal Third Circuit Court of Appeals, *Harris v. Green Tree Financial Corporation*. The Court of Appeals specifically held that a contract provision requiring a consumer to pursue available remedies solely through arbitration was not unconscionable, even though the contract imposed no similar requirement on the lender. Due to the existing conflict between the state and federal courts on this issue resulting from the *Lytle* and *Harris* decisions, a panel of the Third Circuit Court of Appeals, considering *Salley*, requested that the Supreme Court of Pennsylvania resolve Pennsylvania law on the subject.

In its holding, the Supreme Court of Pennsylvania considered Mr. Salley's argument that enforcement of the arbitration provision would give rise to a "split-forum effect," requiring borrowers to argue virtually identical claims defending a foreclosure proceeding by the secondary lender in court while fighting the mortgage company in arbitration. Mr. Salley further maintained that this effect, coupled with the costs of arbitration, created an insurmountable burden on low-income borrowers. The Supreme Court of Pennsylvania, however, relying in part on a decision from the New Jersey Supreme Court in a similar case, found that while a split-forum effect could result in an additional burden on the borrower, such burden did not amount to unconscionability.

The *Salley* holding signals continuing support for arbitration as an alternative to litigation in the courts. While the parties typically bear the costs of arbitration, the process is generally faster and less expensive than formal judicial proceedings. Otherwise, arbitration largely takes the form of a trial at which witnesses may be heard, exhibits are introduced and legal arguments presented. Shumaker Williams, P.C., counsels numerous mortgage lending institutions, and the firm's litigators have successfully handled a variety of arbitration and complex litigation matters involving mortgage lenders. For more information please feel freet o contact Evan Pappas at: Pappas@shumakerwilliams.com.