IN THE SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

NO. 50 EAP 2005

WILL SALLEY, JR.

v.

OPTION ONE MORTGAGE CORP.; CIT GROUP;
JOHN DOE, TRUSTEE, JOHN DOE TRUST
AND JOHN DOES #'S 1-100

BRIEF OF *AMICI CURIAE* THE NATIONAL CONSUMER LAW CENTER,
THE NATIONAL ASSOCIATION OF CONSUMER ADVOCATES,
COMMUNITY LEGAL SERVICES, AND AARP,
IN SUPPORT OF PLAINTIFF-APPELLANT WILL SALLEY, JR.

On Certification of Question of Law from the United States
Circuit Court of Appeals for the Third Circuit

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Dated: February 22, 2006

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES **Pages**

STATEMENT OF INTEREST OF *AMICI CURIAE*

The National Consumer Law Center, Inc. ("NCLC") is a non-profit corporation established in 1969 to carry out research, education, and litigation regarding significant consumer matters. One of NCLC's primary objectives is to assist attorneys in representing the interests of their low-income and elderly clients in the area of consumer law. A major focus of NCLC's work is to increase public awareness of, and to advocate protections against, deceptive sales and financing schemes. NCLC publishes Unfair and Deceptive Acts and Practices (6th ed. 2004), among its many other treatises, to assist attorneys whose clients have been victimized by unfair, fraudulent, or deceptive practices. In addition, NCLC has directly assisted attorneys in scores of cases brought under federal and state consumer protection statutes and regulations.

The National Association of Consumer Advocates ("NACA") is a non-profit group of attorneys and advocates committed to promoting consumer justice and curbing abusive business practices that bias the marketplace to the detriment of consumers. Its membership is comprised of over 1000 law professors, public sector lawyers, private lawyers, legal services lawyers, and other consumer advocates across the country. NACA has established itself as one of the most effective advocates for the interests of consumers in this country.

Community Legal Services ("CLS") provides civil legal assistance to the indigent in Philadelphia. CLS has committed substantial resources to consumer protection on behalf of its low-income clients. CLS advised or represented more than 1,700 clients with consumer protection problems in 2003. CLS, in some cases working with the Philadelphia office of the Pennsylvania Attorney General's Bureau of Consumer Protection, has successfully challenged deceptive practices of a rental referral agency, landlords using lease/purchase agreements and leases to evade the Landlord/Tenant Act and mislead tenants about their rights, for-profit trade schools offering false promises of quick training for high-paying jobs, and predatory mortgage lenders and brokers stripping hard-earned wealth from minority homeowners, among others.

AARP is the largest membership organization in the nation serving the needs and interests of people ages fifty and older, with over 36 million members, 1.8 million of whom live in Pennsylvania. AARP's state advocacy has resulted in passage of seventeen state laws designed to protect consumers from predatory practices in the home mortgage market. AARP attorneys' representation of numerous older Americans has preserved homeownership that was jeopardized by abusive home mortgage practices. Due to its interest in preserving court access for consumers and ensuring they can seek the full range of remedies that Congress and state legislatures enacted for their benefit, AARP has been involved in numerous cases challenging the validity and enforceability of mandatory arbitration provisions.

PRELIMINARY STATEMENT

Amici do not write to criticize arbitrations generally, nor do they intend to suggest that arbitrations are categorically inconsistent with the vindication of consumers' rights. Rather, *Amici* seek to inform the Court about the public policy crisis of predatory home lending that has emerged in recent years and the problematic role that mandatory arbitration clauses play in insulating unscrupulous home mortgage lenders from scrutiny and liability for their wrongdoing. *Amici* thus write to place the issues presented by this case in an important legal and policy context – a context that is critical to understanding Mr. Salley's claims of unconscionability and the impact a ruling in this case will have on Pennsylvania's stated interest in rooting out home mortgage abuses and protecting its most vulnerable home owners and their communities from unnecessary home foreclosures.

Mandatory arbitration agreements can, and frequently do, benefit consumers and corporations alike, while also fostering the interests of judicial economy. However, in instances such as this, where a corporation uses its superior experience, knowledge and bargaining power over the consumer to draft a particularly abusive arbitration agreement, the agreement should not be enforceable. *Amici* regard two provisions of the arbitration agreement in this case particularly objectionable. First, the agreement requires that the parties pay exorbitant costs and fees to the arbitral forum. Such a provision would make it impossible for an indigent person facing foreclosure, such as Mr. Salley, to afford arbitration. Its existence on the face of a contract, even if purportedly ameliorated by a lender's post-signing offer to pay or if severed by a court, would deter most future litigants from even attempting to challenge a lender's conduct.

Second, Option One's arbitration agreement, as Option One drafted it, has the effect of requiring Mr. Salley and other Option One consumers facing a home foreclosure to litigate nearly identical statutory claims twice, at approximately the same time: once against the foreclosing entity, to whom Option One assigned the loan, in state court and again against Option One, for violation of consumer protection statutes, in an arbitral forum. Thus, Option One consumers encounter this "split forum" effect because of the terms of Option One's arbitration agreement coupled with its business practice of selling its subprime loans to qualified special purpose entities on a daily basis. This effect is even more dramatic when Option One retains the rights to service the loan, which it does only for subprime loans. The "split forum" effect places insurmountable practical disadvantages before an indigent litigant such as Mr. Salley, making it effectively impossible for him to vindicate his statutory rights and save his home from foreclosure.

These unconscionable provisions so fundamentally infect Option One's entire arbitration agreement, and would have such a significant deterrent effect on future litigants' ability to bring claims against Option One for abusive home mortgage lending, that they cannot be severed. Thus, the only appropriate remedy, consistent with this Commonwealth's strong public policy against consumer fraud and home lending abuse, is to render the entire arbitration agreement unenforceable.

STATEMENT OF FACTS

At the time of the loan origination at issue, July 2000, Mr. Salley was sixty (60) years old. He is African-American and has little education or financial sophistication. Mr. Salley lives alone and has no financial support other than a meager monthly sum from Social Security of approximately $750, which barely covers his utilities, property taxes, prescriptions, and other medical costs; sometimes, after expenses, Mr. Salley has no money left to buy food.

In 2000, Mr. Salley had lived in his home in Philadelphia, Pennsylvania for over 26 years. A summary of the relevant facts, as alleged in the Complaint, is as follows[1]: Mr. Salley sought to borrow approximately $5,000 to pay off his water bill. He sought to consolidate this new loan with his existing mortgage. Instead of a loan in the modest amount sought, Option One provided Mr. Salley a loan with a principal balance of $51,000. Added to this mortgage amount, were approximately

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[1] See Brief for the Appellant, Salley v. Option One Mortgage Corp., No. 50 EAP 2005, On Pet. for Cert. of Question of Law at 9-11 (Pa. 2005).

$5,000 in settlement costs and fees – charges equal to the total amount Mr. Salley desired to borrow. These costs and fees were added to the principal balance of the mortgage, which carried a variable interest with a minimum APR of 10.65%. The Complaint further alleges that Option One, through undue pressure, coercion, and fraud, imposed upon Mr. Salley a mortgage that he did not understand, could not afford to pay, and would lead to quick and certain foreclosure on his residence. He further alleges that all of this was done in order to extract unreasonable points, fees, and interest payments from him.

In the Certification Petition, the Third Circuit set forth the material and undisputed facts in the case.[2] Mr. Salley is a low-income homeowner in Philadelphia, Pennsylvania, who entered into a residential mortgage loan transaction with Option One, a subprime lender.[3] Option One's standard loan forms included an arbitration clause that provides that all disputes between the parties are subject to binding arbitration. The arbitration clause, however, excludes certain creditor remedies from binding arbitration. Among these exclusions, the clause preserves creditors' access to the courts for any foreclosure proceedings and

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2 See Petition for Certification of Question of Law, Salley v. Option One Mtg. Corp., 2005 WL 3724871, at *1 (3d Cir. Oct. 20, 2005) ("Petition for Certification") ("The material facts here are straightforward and uncontested.").

3 Option One is a subsidiary of H&R Block, Inc. See Option One Mortgage Corporation Website, http://www.oomc.com/corp/corp_aboutus_fastfacts.asp.

self-help remedies, notwithstanding the fact that the clause contains no provisions preserving Mr. Salley's access to the courts to pursue any remedies he may have.

Mr. Salley brought this action in the United States District Court for the Eastern District of Pennsylvania, alleging that Option One engaged in predatory lending practices and violated mortgage law under several state and federal consumer protection statutes. Option One sought to dismiss or stay the action, pending arbitration. "The question before the District Court was whether the Agreement was substantively unconscionable, and therefore unenforceable, because it exempted from arbitration creditor remedies, while requiring the parties to arbitrate other claims." Petition for Certification, at *2.

ARGUMENT

I. PREDATORY LENDING IS A PUBLIC POLICY CRISIS, WHICH IS PERPETUATED BY MANDATORY ARBITRATION CLAUSES THAT CONTAIN THE KIND OF PROVISIONS FOUND IN THIS CASE.

Predatory lending is now properly regarded as a public policy crisis. See U.S. Dep't of Hous. & Urban Dev. & U.S. Dep't of the Treasury, Curbing Predatory Home Mortgage Lending: A Joint Report 28-29 (2000) ("HUD-Treasury Report"), available at http://www.hud.gov/library/bookshelf18/pressrel/treasrpt.pdf; Daniel Immergluck & Marti Wiles, Woodstock Inst., Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development 8 (1999), http://www.woodstockinst.org ("all words" search for:

Immergluck Wiles 1999) ("Predatory lending has reached a scale where it has now been recognized as a major community development problem ... [that] threatens decades of effort in promoting homeownership as a means of wealth creation and neighborhood stabilization."). A comprehensive study of abusive lending practices in Pennsylvania commissioned by the Department of Banking has recently demonstrated the prevalence of and destruction caused by predatory lending in the State, particularly in low-income and minority communities. See Pennsylvania Department of Banking, Losing the American Dream: A Report on Residential Mortgage Foreclosures and Abusive Lending Practices in Pennsylvania 19-27 (Mar. 15, 2005) ("Losing the American Dream").

Recognizing the extent and severity of the problems inflicted upon its residents by predatory lenders, the City of Philadelphia passed a "Prohibition Against Predatory Lending Practices" in 2001. PHILADELPHIA, PA., CODE AND CHARTER §§ 9-2400, et seq. The City Council of the City of Philadelphia made the following legislative findings:

> (a) that citizens from many lower and moderate income neighborhoods in Philadelphia have been unable to access legitimate financing for home purchases and renovations, allowing predatory lenders to thrive; and
>
> (b) that these predatory lenders are charging exorbitant fees and interest rates and are persuading citizens to incur mortgage debt in excess of their needs or ability to pay, often through fraudulent means; and

(c) these predatory lending practices appear to be targeting elderly and vulnerable borrowers; and

(d) that to protect the citizens of Philadelphia and its neighborhoods from lending practices which strip hard earned equity from City residents and contribute to the problem of vacant and abandoned houses by making loans that families cannot afford to repay.

PHILADELPHIA, PA., CODE AND CHARTER § 9-2401.

Months later, the Pennsylvania General Assembly enacted the Pennsylvania Consumer Equity Protection Act outlawing certain home financing practices associated with predatory lending. 63 P.S. §§ 456.501-24. The General Assembly acted to protect all citizens of the Commonwealth whose "financial or other personal circumstances make them vulnerable to predatory lenders who could take advantage of them by making or arranging high-cost loans that borrowers may not be able to repay and by refinancing mortgage loans with added fees that result in the borrower's equity being stripped." 63 P.S. § 456.502(1). Consistent with the actions of the Philadelphia and Pennsylvania legislatures, in the past five years alone, twenty-five states have enacted laws supplementing existing federal consumer protection statutes and federal regulatory activity in an attempt to combat the rash of foreclosures correlated with the rise of predatory lending practices. See U.S. Gen. Accounting Office, Rep. No. GAO-04-412T, Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending, Report to the U.S. Senate Chairman and Ranking Minority Member, Special Committee on Aging 2 (2004) ("GAO Report I"); Baher Azmy, Squaring the Predatory Lending Circle: A Case for States as Laboratories of Experimentation, 57 Fla. L. Rev. 295 (2005)(surveying twenty-five state anti-predatory lending laws enacted within the past six years).

Mr. Salley's socio-economic profile indicates that he fits squarely in the class of vulnerable citizens that the Commonwealth and the City of Philadelphia seek to protect from abusive and predatory lending practices.

A. PREDATORY LENDING HAS LED TO A DEVASTATING RASH OF FORECLOSURES AMONG LOW-INCOME, MINORITY, AND ELDERLY BORROWERS IN PENNSYLVANIA AND NATIONWIDE.

1. The Emergence of Predatory Lending Within the Subprime Lending Market.

Although it is a fairly recent phenomenon and has eluded a single, uniform definition, predatory lending can be "described as subprime mortgage loans and high-interest loans for people with bad credit that are accompanied by egregiously unethical practices, such as hidden exorbitant fees and taxes, grossly inflated sales prices for property, flipping, and making loans to customers who have no realistic ability to repay. Predatory lending also has been defined as subprime lending to people with bad or nonexistent credit records." Michelle W. Lewis, Perspectives on Predatory Lending: The Philadelphia Experience, 491 J. Affordable Housing & Community Dev. L., 493 (2003); see also Losing the American Dream, supra, at

19 (stating that "[a]busive lending practices usually involve some form of deception or fraud, the manipulation of borrowers through aggressive sales tactics, or the taking advantage of a borrower's situation or their lack of understanding of the loan terms.").

The predatory lending explosion has been driven by two related factors. First is the rise of non-traditional, nondepository market participants – mortgage brokers, mortgage bankers, and finance companies. See U.S. Gen. Accounting Office, Rep. No. GAO-04-280, Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending, Report to the U.S. Senate Chairman and Ranking Minority Member, Special Committee on Aging 21-22 (Jan. 2004) ("GAO Report II") (noting that "[f]ifty-nine percent of subprime lenders are independent mortgage companies (mortgage bankers and finance companies)"). Unlike traditional lenders, mortgage bankers and finance companies are relatively unregulated, and typically do not hold their loans within their own portfolios, passing off the risk of default when they sell a mortgage note to assignees in the secondary market. Id. at 27. Option One is one such finance company. See Option One Mortgage Corporation Website, http://www.oomc.com /corp/corp_aboutus_fastfacts.asp (describing itself as "in the business of making, servicing and selling non-prime loans" and "consistently rank[ed] among the top five originators of non-prime residential mortgage loans by volume").

The emergence of predatory lending is inextricably linked to the recent, explosive growth of subprime lending – lending to persons who, because of poor credit history or even discrimination by traditional lenders, have been historically excluded from obtaining credit. See HUD-Treasury Report at 28-29. Option One specializes in such loans to low-income persons.[4] Subprime loans charge higher interest rates and points and fees compared to loans in the prime or conventional mortgage market. By no means are all subprime lenders predatory lenders; however, virtually all predatory lenders operate within and exploit advantages of the subprime market, which in general is less regulated and less competitive than the conventional lending market. See Kathleen C. Engel and Patricia A. McCoy, A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 Tex. L. Rev. 1255, 1270-97 (2002) (describing market dynamics and regulatory deficiencies that allow predatory lenders to thrive within the subprime mortgage market).

Numerous subprime lenders engage in abusive lending practices that can be characterized as predatory. Recognizing this troubling trend, the Federal Trade

[4] See H&R Block, Inc., 2005 S.E.C. Form 10-K at 6 (stating that non-prime mortgages "typically involve borrowers with limited income documentation, high levels of consumer debt or past credit problems. Even though these borrowers have credit problems, they also tend to have equity in the property that will be used to secure the loan."). As noted, Option One is a wholly-owned subsidiary of H&R Block.

Commission (FTC) has investigated and brought charges against several predatory lenders alleging practices similar to the practices of Option One.[5] See Federal Trade Commission; FTC Subprime Lending Cases (since 1998) (listing recent FTC actions) available at http://www.ftc.gov/opa/2002/07/subprimelending cases.htm (last visited Feb. 8, 2006). For example, in 2002 the FTC, Department of Justice, and Department of Housing and Urban Development initiated a joint nationwide investigation and enforcement action against Delta Funding Corporation for conduct similar to that alleged by Mr. Salley, including: systematically lending to low-income borrowers without regard to their ability to repay; charging discriminatorily higher fees to African American borrowers; and providing unearned fees and kickbacks in order to induce brokers to refer loans to Delta Funding. See Press Release, Federal Trade Commission, FTC, DOJ and HUD Announce Action to Combat Abusive Lending Practices (Mar. 30, 2000), at http://www.ftc.gov/opa/2000/03/deltafunding.htm (describing nationwide settlement of these claims).

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[5] There can be no dispute that Option One is a predatory lender. In connection with an enforcement action in the Eastern District of Pennsylvania, Option One reached a settlement with the Department of Justice (DOJ) after DOJ investigations revealed numerous instances of fraud and other consumer abuses in loans originated by Option One. See Press Release, Department of Justice, U.S. Reaches Agreement Designed to Stop Fraud in Lending Practices (March 16, 2005) (available at http://www.usdoj.gov/usao/pae/News/Pr/2005/mar/OptionOne-press-release.pdf).

In the largest such case, Citigroup Inc. agreed to pay $215 million to settle the FTC's charges that a "subsidiary engaged in systematic and widespread deceptive and abusive lending practices." See Press Release, Federal Trade Commission, Citigroup Settles FTC Charges Against the Associates Record-Setting $215 Million for Subprime Lending Victims (Sept. 19, 2002), at http://www.ftc.gov/opa/2002/09/associates.htm (describing the settlement of these claims).

The second factor driving the growth of predatory lending is the process of "securitization," by which mortgage finance companies sell groups of subprime loans as securities on the open market, putting the foreclosure remedy in the hands of an assignee. "Substantially all [of Option One's] non-prime mortgage loans are sold daily" through securitizations.[6] The securitization phenomenon, which now plays a dominant role in the subprime lending industry,[7] is the reason that enforcement of Option One's mandatory arbitration clause will put many future victims of predatory lending in the untenable position of litigating in two forums in order to save their home from foreclosure. Because many subprime loans now

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6 See H&R Block, Inc., 2005 S.E.C. Form 10-K at 7.

7 In 2002, for example, 63% of new subprime mortgages, representing $134 billion, were securitized; and in 2003, securitizations of subprime mortgages reached a total value of $203 billion. Subprime Lenders Shatter Records in '03 and Get Set for More in '04, Inside B&C Lending, Feb. 9, 2004, at 3.

contain mandatory arbitration clauses, see infra at 23-25, a victim of predatory lending trying to save his home will have to challenge the loan originator's conduct both in defending the foreclosure action brought by the assignee-noteholder in state court and in litigating against the loan originator (Option One in this case) in a separate, arbitral forum.

2. Typical Predatory Practices

Predatory lenders impose a variety of oppressive lending terms and engage in a variety of unscrupulous lending practices in order to extract extraordinary rents or profits for themselves. See generally Azmy, supra, 57 Fla. L. Rev. at 319-43; HUD-Treasury Report at 69-96. Many such practices, described here, are at issue in this case.

a. Excessive Rates and Fees

Excessive rates and fees are at the heart of nearly all predatory loans. While subprime lenders attempt to justify higher interest rates by citing a purportedly higher risk associated with low-income borrowers, studies conducted by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") have demonstrated that rates charged in subprime loans frequently are far costlier than is justified given the risk profile of a subprime borrower. See Peter Zorn et al., Subprime Lending: An Investigation of Economic Efficiency at 5 & Ex. 3 (Dec. 21, 2000); Remarks of Franklin D.

Raines, Chairman and CEO of Fannie Mae, to the National Community Reinvestment Coalition (Mar. 20, 2000), at http://www.fanniemae.com/media/speeches/speech.jhtml?repID=/media/speeches/2000/speech_116.xml&p=Media&s=Executive+Speeches&counter=1 (estimating that half of subprime borrowers could have qualified for prime rate loans if made available to them).

In this case, Mr. Salley's mortgage carried an adjustable interest rate that could increase during the term of the loan, but could not decrease below the minimum APR of 10.65%.[8]

In addition, predatory lenders typically add to already high interest rates by charging points and fees that go directly to the loan originator or broker as a cash payment. While points and fees have all but disappeared from the competitive conventional mortgage market, fees in the subprime and predatory market frequently far exceed any reasonable market justification. See Azmy, supra, 57 Fla. L. Rev. at 326 & nn.139-150 (citing variety of estimates or excessive average points and fees associated with predatory loans); Losing the American Dream, supra, at 20 (discussing fees greatly in excess of those justified by the credit worthiness of the borrower); HUD-Treasury Report, supra at 21 (same). Indeed, investigations of

8 The impact of such an interest premium can be devastating for low or fixed-income borrowers. For example, Mr. Salley's minimum APR at 10.65% required monthly payments of about $472.25. His monthly income during this time was approximately $750 from Social Security, leaving him with only about $278 per month to cover utilities, transportation, property taxes, prescriptions, medical costs and food.

predatory lenders' abusive practices often reveal that predatory lenders systematically charged points and fees above ten percent. See, e.g., People v. Delta Funding Corp., No. CV99-4951 (E.D.N.Y. Aug. 19, 1999) (complaint and jury demand).

The cost of high points and fees is compounded by the fact that they are usually folded into the loan amount and financed by the borrower. This increases the loan amount and thereby depletes a borrower's equity by a corresponding amount. In this case, almost $5,000 of Mr. Salley's loan total – or approximately 10% – went to points and fees and were then folded into loan principal and financed at the minimum 10.65% APR.

b. Lending Without Regard to a Borrower's Ability to Repay

In addition, predatory lenders frequently make home refinance loans based on the amount of equity in borrowers' homes, collecting high points or fees for themselves, even if such borrowers lack sufficient income to make monthly payments. See HUD-Treasury Report at 76 (describing such practices as "asset based lending" or "lending without regard to ability to repay"). These practices, not surprisingly, result in quick and exploitative foreclosures. See Losing the American Dream, supra, at 19. A study of predatory lending in Pennsylvania revealed that nearly half of the subprime borrowers surveyed reported problems repaying their loans. See ACORN Fair Housing, Predatory Lending in South Central Pennsylvania: A Review of Rising Foreclosure Filings and the Relationship to Predatory Lending (2003). Strikingly, as much as 90% of those subprime loans were unaffordable to the borrower at the time the loans were made. See id. In some of these instances the lender seeks to profit by reselling the house after foreclosure, while in others it provides the lender the opportunity to strip away huge amounts of the borrower's equity in their home. See id at 22.

Predatory lenders prey on the elderly so frequently because the elderly have often built substantial equity in their homes and can therefore provide sufficient collateral for a large home equity loan, with large points and fees for the lender. See Losing the American Dream, supra, at 19 ("In some cases, elderly people living on fixed incomes ended up having monthly payments that equaled or exceeded their monthly incomes.").

Mr. Salley alleges such asset-based lending in this case: while he possessed equity in his home, his $750 gross monthly income was manifestly insufficient, in light of necessary expenses, to make the monthly payments of $472 on this loan. Nevertheless, these parties foisted a high cost, unaffordable, foreclosure-bound loan upon him.

c. Aggressive Sales Tactics, Coercion and Fraud

Victims of predatory lending frequently have little connection to or experience with financial markets, are elderly or infirm, have no relationship with a bank or connections to family or friends through which to seek advice, all of which makes them perfect targets of unscrupulous lenders. See Azmy, supra, 57 Fla. L. Rev. at 344. Accordingly, predatory lenders have developed specialized techniques to identify vulnerable and financially unsophisticated targets in predominantly lower income and minority communities. Once identified, the lenders engage in highly aggressive marketing techniques, manipulative sales tactics, or outright fraud, almost always advertising a way to consolidate credit card debt, refinance a home, and afford home repair. See Kurt Eggert, Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine, 35 Creighton L. Rev. 503, 515-16 (2002) (cataloguing a variety of marketing techniques of predatory lenders); HUD-Treasury Report at 17 (stating that a predatory lender "often provides misinformation, manipulates the borrower through aggressive sales tactics, and/or takes unfair advantage of the loan terms and their consequences"). According to the congressional testimony of a former predatory lender:

> [M]y perfect customer would be an uneducated widow who is on a fixed income, hopefully from her deceased husband's pension and Social Security, who has her house paid off, is living off of credit cards, but having a difficult time keeping up with her payments. . . .

See Equity Predators: Stripping, Flipping and Packing Their Way to Profits: Hearing Before the Senate Special Comm. on Aging, 105th Cong. 2 (1998) (Testimony of "Jim Dough," anonymous former employee of a predatory lender).

Minority, low-income, and elderly homeowners are especially vulnerable to these tactics, as well as those who are delinquent on their existing mortgage and at risk of foreclosure. Losing the American Dream, supra, at 20. Unscrupulous home improvement contractors are a prime source for predatory loans. Such contractors may troll low-income neighborhoods, looking for a house in disrepair, and then arrange financing for improvements with a lender who is complicit in issuing a high-cost, high fee loan. HUD-Treasury Report at 39. In this case, Mr. Salley – elderly, uneducated, alone, African American, and therefore the "perfect" prey for unscrupulous lenders – alleges he was duped by precisely such a scheme.

3. The Impact of Predatory Lending on Poor and Minority Communities in Pennsylvania

One of the most startling features of the predatory lending problem is its disproportionate presence in, and impact upon, minority communities. Daniel Immergluck & Geoff Smith, Risky Business: An Econometric Analysis of the Relationship Between Subprime Lending and Neighborhood Foreclosures 23 (2004) ("Risky Business") ("Subprime lending is the dominant driver of the increased and highly concentrated neighborhood foreclosure levels of the late 1990s and throughout 2002.”). According to HUD analysis, half of all mortgage lending in predominantly African American neighborhoods was subprime, compared to only nine percent in predominantly white neighborhoods – making African Americans on average five times more likely to obtain subprime loans than white persons. U.S. Dep’t of Hous. & Urban Dev., Unequal Burden: Income and Racial Disparities in Subprime Lending in America 3 (2000). Controlling for income, the comparison becomes even starker. Nationwide, upper-income African American borrowers are more than two times as likely as low-income white borrowers to obtain subprime refinance loans. Id. These disparities have been documented in dozens of scholarly articles and are confirmed periodically, including most recently by a comprehensive 2005 Federal Reserve Board study. See Robert B. Avery, Glenn B. Canner, Robert E. Cook, New Information Reported Under HMDA and Its Application in Fair Lending Enforcement, Federal Reserve Bulletin, at 344-394 (Summer 2005), at http://www.federalreserve.gov/pubs/bulletin/2005/3-05hmda.pdf.

Abusive lending practices disparately impact poor, elderly and minority borrowers in Pennsylvania as well. See Losing the American Dream, supra, at 17. A Pennsylvania study demonstrated a consistent statewide pattern of foreclosures concentrated in areas with lower than average incomes and higher than average African American and Hispanic populations. The Reinvestment Fund, Mortgage

Foreclosure Filings in Pennsylvania 37 (2005).

The cumulative effect of targeting minority communities for predatory loans – what has been called "reverse redlining"[9] – has both dramatically increased the number of foreclosures on African American residences and the speed at which they occur. HUD-Treasury Report at 50. Foreclosed homes in low or moderate-income or minority areas tend to have greater negative externalities than in upper-income areas by causing a spiral of depressed property values in the community and depriving cities, counties, and school districts of tax revenue, and overall tend to "have a devastating effect on their stability and development prospects." Risky Business, supra, at 1, 4-5. "Even in periods of strong economic growth, there is a relatively high incidence of foreclosure among subprime loans in lower-income and minority neighborhoods." Losing the American Dream, supra, at 16. Pennsylvania's mortgage foreclosure rate for subprime loans reached 11.9% in 2003, which is the 4th highest level in the nation and an astonishing 1400% higher than prime foreclosure rate of 0.85%. Id.; Mortgage Foreclosure Filings in Pennsylvania, supra, at 7.

Considering the importance of home ownership to accessing the metaphorical American dream and the critical tangible benefits it provides, such as

[9] Hearing on Predatory Mortgage Lending, U.S. Sen. Comm. On Banking, Housing and Urban Affs., July 27, 2001 (Testimony of David Berenbaum, Director of Civil Rights, National Community Reinvestment Coalition).

financial stability and community membership, the explosion of predatory lending and its direct contribution to a devastating rash of residential foreclosures in minority communities should be considered a critical civil rights issue. The Pennsylvania General Assembly acknowledged this much in passing the Consumer Equity Protection Act. See 63. P.S. § 456.502 (finding that "[a]ll citizens are entitled ... to share in the American dream of homeownership, including those whose financial or other personal circumstances make them vulnerable to predatory lenders...").

B. MANDATORY ARBITRATION CLAUSES SUCH AS OPTION ONE'S ARE A CENTRAL PART OF A PREDATORY LENDER'S STRATEGY TO AVOID SCRUTINY OF ITS PRACTICES.

While mandatory arbitration agreements often offer parties a fair alternative for dispute resolution – particularly in merchant and sports disputes – such agreements have a substantially different impact upon consumers in the subprime lending market. See HUD-Treasury Report at 98. Where, as here, a creditor may use the authority of the courts to foreclose upon a consumer's home while the consumer must separately pursue his or her claims in a different, informal forum, the arbitration agreement exerts hydraulic pressure on the consumer to capitulate, by filing for bankruptcy or abandoning or relenting on the affirmative claims. Though the existence of a mandatory arbitration agreement alone does not indicate the existence of a predatory loan, such arbitration agreements are a commonly recognized feature of predatory loans. See id.; Engel & McCoy, supra, 80 Tex. L. Rev. at 1270; see also Center for Responsible Lending, Abusive Practices: 7 Signs of Predatory Lending, at http://www.responsiblelending.org/abuses/abusive.cfm (noting that "[i]ncreasingly, lenders are placing pre-dispute, mandatory binding arbitration clauses in their loan contracts").

The negative impact of mandatory arbitration agreements is peculiar to consumers of subprime loans because the subprime lending market has not yet evolved into a competitive marketplace where subprime borrowers can choose between a loan that contains an arbitration agreement and another loan that does not. HUD-Treasury Report at 98. The leading government study on the predatory lending problem identified mandatory arbitration as a catalyst for predatory lending:

> Many high-cost loan borrowers may not understand at the time of closing the significance of agreeing to arbitration and various associated terms, such as cost allocation and forum allocation. Consumers might not recognize a mandatory arbitration clause buried in the voluminous loan documents at closing. In addition, private arbitration circumvents the development of clear and uniform standards for compliance with federal fair lending and consumer protection law through the decisions of an independent judiciary.

HUD-Treasury Report at 98; see id. at 99 (recommending national regulation prohibiting use of mandatory arbitrations in connection with high cost loans); see also Statement of David Medine, Associate Director, FTC Bureau of Consumer Protection, to House Committee on Banking and Financial Services (May 24,

2004) at http://www.ftc.gov/os/2000/05/predatorytestimony.htm at 8 (noting the large increase of mandatory arbitration agreements in subprime loans and recommending their prohibition in connection with high cost loans).

Recognizing the unfairness mandatory arbitration clauses can create in connection with mortgage loans, government sponsored entities Fannie Mae and Freddie Mac have ceased purchasing all mortgage loans with these clauses. See Kenneth R. Harney, Fannie Follows Freddie in Banning Mandatory Arbitration, Wash. Post, Oct. 9, 2004, at F1. Thus, Fannie Mae and Freddie Mac, as the largest purchasers of conventional mortgages, recognize that mandatory arbitration clauses contribute to the abusive mortgage lending problem by cutting off meaningful redress for victims of lending fraud.

The Federal Trade Commission has also recognized that "mandatory arbitration agreements undermine consumers' ability to exercise statutory rights conferred by the [Truth in Lending Act], HOEPA, and [Equal Credit Opportunity Act], and other laws which were passed to protect consumers in the credit marketplace." See Statement of Medine, supra, at 9.

II. BECAUSE THE COST ALLOCATION PROVISION AND THE SPLIT-FORUM EFFECTS OF THE ADHESIVE MANDATORY ARBITRATION AGREEMENT IN THIS CASE ARE OPPRESSIVE AND WILL DETER MEANINGFUL REDRESS OF THE PREDATORY LENDING CRISIS, THE ENTIRE AGREEMENT IS UNCONSCIONABLE AS A MATTER OF LAW.

Amici do not dispute or challenge the Commonwealth's long established public policy generally favoring the settlement of disputes by arbitration, consistent with the Federal Arbitration Act, 9 U.S.C. § 2. See, e.g., Carll v. Terminix Int'l Co., L.P., 2002 Pa. Super. 44, 793 A.2d 921, 924 (2002) (citing Children's Hosp. of Phila. v. American Arbitration Ass'n, 231 Pa. Super. 230, 331 A.2d 848 (1974)). However, arbitration agreements that impede a "litigant . . . from effectively vindicating her . . . statutory rights" are disfavored and unenforceable. See Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 90, 121 S. Ct. 513, 522, 148 L. Ed. 2d 373, 383 (2000). Similarly, arbitrations otherwise governed by the Federal Arbitration Act are constrained by the state law of contract. See 9 U.S.C.A. § 2; First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944, 115 S. Ct. 1920, 1924, 131 L. Ed. 2d 985, 993 (1995). Pennsylvania law precludes enforcement of arbitration agreements that are found to be unconscionable under basic contract law. See Carll v. Terminix Int'l Co., L.P., 2002 Pa. Super. 44, 793 A.2d 921 (2002); accord Allied-Bruce Terminix Co. v. Dobson, 513 U.S. 265, 281, 115 S. Ct. 834, 843, 130 L. Ed. 2d 753 (1995) ("States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of any contract.'" (emphasis original, citations omitted)). Under Pennsylvania law, arbitration agreements are unconscionable if they "include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." Witmer v. Exxon Corp., 495 Pa. 540, 551, 434 A.2d 1222, 1228 (Pa. 1981) (emphasis original) (citing Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965)).

The arbitration agreement in this case is a contract of adhesion, defined as a "form contract prepared by one party, to be signed by the other party in a weaker position, usually a consumer, who has little choice about the terms." McNulty v. H&R Block, Inc., 2004 Pa. Super. 45, 843 A.2d 1267, 1273 (2004) (internal citations omitted). Adhesion contracts are not per se unconscionable. Id. Rather, the test of unconscionability in Pennsylvania has two prongs: 1) the contract unreasonably favors the drafter, and 2) the other party possesses no meaningful choice regarding the acceptance of the contract. See id; Witmer v. Exxon Corp., 495 Pa. at 551, 434 A.2d at 1228; Metalized Ceramics for Elec.'s, 444 Pa. Super. 238, 663 A.2d 762 (1995); Denlinger, Inc. v. Dendler, 415 Pa. Super. 164, 608 A.2d 1061 (1992). Although adhesion contracts are not per se unconscionable, by definition they satisfy the second prong of the unconscionability test that the other party has no meaningful choice of whether to accept the contract terms. McNulty v. H&R Block, Inc., 843 A.2d at 1273.

While addressing all relevant doctrinal considerations, Amici wish to emphasize the public policy interests implicated by the mandatory arbitration provisions at issue. As described, the arbitration agreement in this case must be viewed in the context of the surging crisis in abusive home mortgage lending. In all practical respects, arbitration agreements such as the one in this case operate as exculpatory clauses to the benefit of Option One and other subprime lenders. Though preserving access to the courts for creditor remedies, consumers' remedies are subject to binding arbitration. However, the terms of the binding arbitration in instances such as this make its pursuit impractical and thus tantamount to no consumer remedy at all. Few, if any, subprime borrowers can afford the high costs of arbitration. Further, since arbitrations are private and not precedential, the burden on each consumer seeking relief is great, while predatory lenders receive repeated opportunities to escape liability. *Amici* acknowledge that all arbitrations are private and not precedential. However, this has a peculiar effect on subprime loan consumers because of predatory lenders' uniform use of mandatory arbitration agreements and the consistent patterns of abuse that tend to be concentrated in particular areas. This results in an absence of judicial decisions which would otherwise clearly outlaw particular conduct or more specifically define abusive lending practices. Many of the statutes mentioned above have been passed in recent years to protect consumers of subprime loans, but their impact has been impeded by the virtually exclusive use of mandatory arbitration agreements in predatory subprime mortgage loans. See HUD-Treasury Report, supra, at 98-99.

In this case, the arbitration agreement puts Mr. Salley in the untenable position of having to raise origination claims to defend against a foreclosure action brought by the noteholder in State court, while separately and simultaneously pursuing nearly identical affirmative claims against Option One in arbitration. This "split-forum" effect produces an immense and virtually insurmountable litigation burden for Mr. Salley, and therefore functionally shields Option One and other subprime loan originators from liability. Accordingly, if the Court orders the enforcement of this arbitration agreement, *Amici* firmly believe that victims of predatory lending will be unable to marshal an adequate defense to the foreclosure of their homes or vindicate their statutory rights against subprime lenders that originate unscrupulous loans.[10]

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[10] In Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627, 637 n.19 (1985), the Court emphasized that courts should remain attuned to well-supported claims of unconscionability: "We . . . note that in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies . . ., we would have little hesitation in condemning the agreement as against public policy."

A. OPTION ONE'S ARBITRATION AGREEMENT IS UNCONSCIONABLE UNDER PENNSYLVANIA LAW.

Option One's arbitration agreement satisfies both requirements for a finding of unconscionability: 1) the agreement is unreasonably favorable to Option One, and 2) Mr. Salley had no meaningful choice regarding the acceptance of the terms. The arbitration agreement represents an adhesion contract and therefore automatically satisfies the second requirement of the unconscionability test. McNulty v. H&R Block, Inc., 843 A.2d at 1273. Further, the cost bearing provision, in conjunction with the "split-forum" effect make the arbitration agreement unreasonably favorable to Option One because it has the practical effect of depriving Mr. Salley of the remedies to which he would otherwise be entitled and able to obtain through the use of a judicial forum. Option One and its agents employed significant coercion and exploited their greatly superior bargaining power over Mr. Salley. Finally, the public interests affected by the arbitration agreement – namely, the Commonwealth's strong public policy in rooting out home lending abuse – weigh greatly against enforcing it.

1. The Relative Bargaining Position Between Mr. Salley and Option One was So Disparate, and the Degree of Economic Compulsion Motivating Mr. Salley So Severe, that the Agreement is Rendered Unconscionable.

The strong presumption in favor of enforcement of contracts presumes free consent between parties of relative bargaining equality. See generally Denlinger, Inc. v. Dendler, 415 Pa. Super. at 173-74, 608 A.2d at 1066 (citing Galligan v. Arovitch, 421 Pa. 301, 219 A.2d 463 (1966)); Germantown Manufacturing Co. v. Rawlinson, 341 Pa. Super. 42, 491 A.2d 138 (1985). A severe disparity in bargaining power can invalidate a contract. Peoples Mortgage Co., Inc. v. Fed. Nat'l Mortgage Ass'n, 856 F. Supp. 910, 927 (E.D. Pa. 1994) (unconscionability exists where the economic position of a party alone can warrant a finding that the party "was so vulnerable as to make him the victim of a grossly unequal bargain").

While Mr. Salley – an elderly, uneducated African American man in a financially isolated community – is the paradigmatic victim of predatory lending, Option One is an extremely large, experienced lender specializing in high cost loans. See H&R Block, Inc., 2005 S.E.C. Form 10-K at 8 (Option One was ranked as the 7th largest originator of subprime loans in the U.S.). This imbalance contributes to a finding of unconscionability. As the Superior Court explained in Germantown Manufacturing Co. v. Rawlinson:

> The standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing. The need for application of this standard is most acute when the professional seller is seeking the trade of those most subject to exploitation-the uneducated, the inexperienced and the people of low incomes... Unconscionability and the other methods of avoiding an unfair contract examined herein do nothing more than reaffirm the most basic tenet of the law of contracts-that parties must be free to choose the terms to which they will be bound.

341 Pa. Super. at 56, 491 A.2d at 145-46; cf. Carll v. The Terminix Int'l Co., L.P.,

793 A.2d at 925 ("in a consumer contract there is most often disparity between the parties"); Denlinger, Inc. v. Dendler, 415 Pa. Super. at 173-74, 608 A.2d at 1066 (recognizing differences between repeat, experienced commercial player and consumer lacking experience as significant determination of unconscionability).

Option One, like other predatory lenders, has recognized that Mr. Salley obviously could not understand that, with this adhesion agreement presented to him among a large stack of loan closing documents, he would be ceding to Option One a substantial litigation advantage should he ever seek to challenge the loan issued to him. As the Federal Trade Commission reports,

> In the [Federal Trade] Commission's enforcement experience, consumers may be presented with an arbitration agreement for the first time at loan closing, with no prior notice of the requirement, and among a stack of other complicated loan documents. At that time, even if consumers have an opportunity to read the agreement, consumers are unlikely to inquire about it out of fear they will lose the loan. . .

See Statement of Medine, supra, at 8. The fiction of genuinely consenting to arbitration as a bargained-for-exchange is heightened to the extreme in a forum-splitting context which no reasonable borrower could ever anticipate. The pressure exerted upon Mr. Salley by Option One in foisting an arbitration remedy upon him, while reserving its right to pursue foreclosure in state court, compounded by his lack of options and the extreme disparity in bargaining power between the parties, renders the arbitration agreement unconscionable because it unreasonably favors the drafter.

2. The Strong Public Interest in Policing and Preventing Predatory Lending is Severely Undermined by Option One's Arbitration Agreement.

A court must evaluate whether enforcement of an adhesion contract is consistent with the public interest. Commonwealth ex rel Creamer v. Monumental Properties. Inc., 314 A.2d 333, 339 (Pa. Commw. 1973), aff'd in part, rev'd in part on other grounds, 459 Pa. 450, 329 A. 2d 812 (1974). Under Pennsylvania law, the determination of whether a contract of adhesion exists must be based on the specific parties and circumstances involved, including whether severely unequal bargaining power exists. Id. Contracts of adhesion that violate public policy "should be given no legal effect." Id.; V. J. Hajjar Assocs., Inc. v. Med. Serv. Ass'n of Pa., 15 Pa. D. & C.3d 251, 258, 1980 WL 636, at *4 (Pa. Com. Pl June 30, 1980). Importantly, our "Supreme Court acknowledged the power of the courts to pronounce public policy in the absence of contrary statements by the legislature." Rothrock v. Rothrock Motor Sales, Inc., 53 Pa. D. & C.4th 411, 417, 2001 WL 1808562 (Pa. Com. Pl. July 19, 2001) (citing Shick v. Shirey, 552 Pa. 590, 716 A.2d 1231 (1998)).

Our General Assembly enacted the Unfair Trade Practices and Consumer Protection Law (UTPCPL), 73 P.S. §201-1 et seq., "to benefit the public by prohibiting a variety of deceptive and unfair business practices. Its aim is the prevention of fraud and must be liberally construed to effect this purpose." Commonwealth ex rel. Zimmerman v. Nickel, 26 Pa. D. & C.3d 115, 119, 1983 WL 286, at *3 (Pa. Com. Pl. Jan. 24, 1983) (citing Commonwealth ex rel Creamer v. Monumental Properties, Inc., 459 Pa. 450, 459, 329 A. 2d 812, 816-817 (1974), on remand, 26 Pa. Commw. 399, 365 A. 2d 442). In addition, the Pennsylvania Consumer Equity Protection Act demonstrates the State's legislative commitment to rooting out home mortgage lending abuse and other practices that have contributed to the alarming pace of foreclosures among Pennsylvania's home owners. 63 P.S. §§ 456.501 et seq.; see also Mortgage Foreclosure Filings in Pennsylvania, supra, at 77-78; Losing the American Dream, supra, at 30-31.

The mandatory arbitration agreement employed by Option One in this case will undoubtedly make it harder for victims of predatory lending to vindicate a variety of statutory remedies designed to deter abusive lending practices and punish unscrupulous lenders. Such an event would therefore conflict with the Commonwealth's strong public policy protecting consumers and homeowners from abuse. Specifically, several features of the arbitration agreement are unconscionable and ultimately, unseverable.

a. The "Split-Forum" Effect Created by Option One's Arbitration Agreement Also Places Oppressive Conditions on Mr. Salley's Ability to Vindicate His Statutory Rights.

The arbitration agreement requires that all claims brought by Mr. Salley against Option One proceed in arbitration and requires that any foreclosure action proceed in State court. Therefore, in order to save his home, Mr. Salley must defend the foreclosure in State court against the trustee-noteholder, while separately and simultaneously raising affirmative claims – based on nearly identical causes of action under the Pennsylvania Consumer Equity Protection Act, 63 P.S. §§ 456.501 et seq., and Truth in Lending Act, 15 U.S.C.A. § 1640(a), against Option One in arbitration.[11] This "split forum" effect places overwhelming practical barriers before Mr. Salley that make it effectively infeasible for him or counsel to vindicate his statutory rights against his two adversaries.

The adverse "split forum" effect is even more dramatic when Option One retains the servicing rights to a loan that it has sold and securitized (a practice Option One engages in only for its subprime loans). See H&R Block, Inc. S.E.C. 2005 Form 10-K at 7 ("We only service non-prime mortgage loans"). Further, it is Option One's standard operating practice to sell "[s]ubstantially all non-prime mortgage loans" for securitization, but "retain the right to service them." Id.[12]

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[11] *Amici* note that this Court recently adopted new Rules of Civil Procedure, effective February 1, 2006, which require a plaintiff to initiate a civil action in order to compel arbitration of a claim. See Pa. R. Civ. P. 1326-31. It is unclear how these rules would operate in the split-forum context created by Option One's arbitration agreement.

[12] See H&R Block, Inc. S.E.C. 2005 Form 10-K at 36-37 (providing a detailed description of Option One's off-balance sheet financing arrangements which relate primarily to its practice of selling and securitizing its subprime mortgage loans).

Under these circumstances, if Option One errs in the servicing of the subprime loan (i.e., fails to or incorrectly applies a mortgage payment, or fails to remit taxes from the escrow account), the consumer would face foreclosure proceedings in state court (brought either by the holder of the mortgage or the state). But, under this arbitration agreement, he would also be forced to undertake a separate, duplicative arbitration proceeding simply to resolve Option One's loan servicing error (notwithstanding any claims for violation of consumer protection laws). Thus, the "split-forum" effect of the arbitration provision is aggravated by the split in loan ownership and servicing to make it practically impossible for a consumer to efficiently and effectively defend his home by affirmatively asserting mis-servicing claims against Option One.

It is important to recognize that this split-forum predicament is not an isolated procedural oddity or even a hypothetical tactical possibility. In fact, "[u]sing securitization, many predatory originators and brokers have learned to specialize in running judgment-proof operations." Christopher L. Peterson, Federalism and Predatory Lending: Unmasking the Deregulatory Agenda, 78 Temp. L. Rev. 1, 27-28 (2005) (describing how mortgage loan originators can deprive borrowers of potential defenses by assigning the loan). Because of the dominance of securitization in the subprime market, a foreclosing entity will almost always be different than the mortgage banker or finance company that originated an allegedly illegal loan. Frequently, as in this case, defending the foreclosure action will involve litigation of claims and issues against the assignee that would also create liability for the loan originator.[13] Mr. Salley and borrowers like him not only will want to raise identical legal claims against both entities, but also may need to demonstrate that some relationship – such as cooperation, knowledge, or responsibility – between the two existed. Naturally, borrowers would be seriously disadvantaged by Option One's and the noteholder's "divide and conquer" strategy because the borrowers would lose the ability to present a related case in one forum and before one fact finder.

Relegated to two forums, and forced to defend against separate corporate entities in each, Mr. Salley would not be able to obtain from the noteholder the information necessary to defend his home in State court. Instead, because his foreclosure defenses are grounded in abuses in the loan origination process, Mr. Salley would first be required to seek this essential information from Option One in the arbitration proceeding, and only then could he use it to support his defenses against the noteholder in the judicial proceeding. It is especially unfair to impose this burden on elderly, indigent individuals such as Mr. Salley who, in seeking to

[13] In addition, the typical victim of predatory lending rarely is in a position to discover wrongdoing on the part of a lender or broker. In the vast majority of cases, predatory lending victims only recognize the illegality of a loan or its servicing after they have received notice of foreclosure by a noteholder and have retained experienced counsel.

save their homes, must face two very large and frequently-cooperating corporate entities.

Litigating identical issues regarding a loan originator's liability in two forums, moreover, creates the real possibility of inconsistent judgments. By contrast, where both parties must appear together in one forum, a borrower may be able to use money obtained from the loan originator – either by judgment or by settlement – to pay off the foreclosing entity and cure the loan default. This critical sequence would be highly unlikely to replicate where there are two forums operating on different schedules.

In addition, the split-forum effect would give Option One a significant discovery advantage over Mr. Salley. Discovery against Option One in the arbitration forum is both expensive and generally limited to depositions. A complex case such as this cannot be efficiently or effectively litigated by employing costly depositions alone. See Mark E. Budnitz, Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection, 10 Ohio St. J. on Disp. Resol. 267, 283 (1995) (explaining that the extremely limited and discretionary discovery available in arbitrations "is a far cry . . . from a party having at its disposal the wide array of discovery techniques such as interrogatories, motions to produce documents, depositions, etc. . .").

To suggest that Option One faces an equal burden from severely limited discovery in the arbitration proceeding itself would completely ignore the obvious realities of this kind of litigation: predatory lending cases are extremely complex, frequently involve scores of documents and dozens of players, and almost exclusively involve information in the possession of the lender, not the borrower. Option One and the noteholder would likely need little or no discovery from Mr. Salley in this case and, as such, the discovery consequences of the split forum give them an enormous practical advantage over him. As one scholar explained,

> The unavailability of discovery skews the system in favor of the corporate defendant. The plaintiff has the burden of production of evidence, much of which the defendant may well possess. . . . The combination of these factors makes arbitration a highly attractive alternative to litigation for corporate defendants in many circumstances.

David S. Schwartz, Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration, 1997 Wisc. L. Rev. 33, 61 (1997). Given Mr. Salley's predicate need for arbitral discovery from Option One to defend his home against the noteholder's foreclosure action, the arbitral restraints on discovery create insurmountable barriers to his foreclosure defense.

In application, Option One's "split-forum" provision functions like the confession of judgment clauses long outlawed in the consumer context. See Swarb v. Lennox, 405 U.S. 191 (1972); Fuentes v. Shevin, 407 U.S. 67 (1972). In both Swarb and Fuentes, the Supreme Court refused to enforce confession clauses that forced consumers to surrender certain basic constitutional rights, including the right to a jury trial and the right to adequate notice and opportunity to be heard. Id. The Supreme Court made it clear that there must be affirmative proof of a knowing and voluntary waiver and specific consideration where a consumer has given up fundamental rights in an adhesion contract. See id.; c.f. D.H. Overmyer Co. v. Frick Co., 405 U.S. 174, 188 (1972) (distinguishing a confession of judgment provision in a commercial contract from such a provision in a consumer contract). In Fuentes, the Supreme Court refused to enforce the provision, emphasizing the following facts (also present in this case):

> There was no bargaining over contractual terms between the parties who, in any event, were far from equal in bargaining power. The purported waiver provision was a printed part of a form sales contract and a necessary condition of the sale. The appellees made no showing whatever that the appellants were actually aware or made aware of the significance of the fine print now relied upon as a waiver of constitutional rights.

Fuentes, 407 U.S. at 95.

The facts underlying the Supreme Court's refusal to enforce confession of judgment clauses against consumers closely mirror the facts in the present case. As in Swarb and Fuentes, Option One has utterly failed to present any proof that Mr. Salley "knowingly and voluntarily" agreed to give up his fundamental rights. Accordingly, Option One's arbitration agreement is unconscionably one-sided.

Further, the "split-forum" effect created by Option One's arbitration agreements runs counter to Pennsylvania's Rules of Civil Procedure. Under Rule

1148, a defendant in a mortgage foreclosure action has a right to plead counterclaims that arise from the same transaction(s) or event(s) that give rise to the plaintiff's action. Pa. R. Civ. P. 1148. Option One's arbitration agreement, in effect, circumvents Pennsylvania's Rules of Civil Procedure regarding mortgage foreclosure actions by depriving consumers of their right to assert affirmative defenses and counterclaims through the foreclosure proceedings, relegating only those pleadings to the arbitral forum. Cf. Pa. R. Civ. P. 1326-1331. Option One has again failed to present any proof that Mr. Salley "knowingly and voluntarily" waived these important rights. At a minimum, therefore, an evidentiary hearing is required so Mr. Salley may test whether Option One can satisfy its burden of proof with respect to the volutariness and one-sidedness of the arbitration clause.[14]

b. The Cost Allocation Provisions of the Agreement are Oppressive to Litigants Such as Mr. Salley.

The imposition of large arbitration costs is also a well settled reason for invalidating an arbitration provision. See Green Tree, 531 U.S. at 90; Parilla v.

[14] The "split-forum" in this consumer context is markedly different from the "split-forum" briefly mentioned by the Supreme Court in Moses H. Cone Memorial Hosp. v. Mercury Const. Corp., 460 U.S. 1, 20-21, 103 S. Ct. 927 (1983). In that case, unlike here, a contractor and a hospital agreed to arbitrate payment disputes even though the hospital's claims against its architect would be subject to litigation. There was no threat of foreclosure in that context, nor were the parties in unequal bargaining positions. Hence, the Court's comments concerning piecemeal adjudication did not address the unconscionable practical effect of a "split-forum" in the predatory lending context, and the Court in no way established a rule respecting "split-forums".

IAP Worldwide Services, VI, Inc., 368 F.3d 269, 284 (3d Cir. 2004) ("[A]n arbitration provision that makes the arbitral forum prohibitively expensive for a weaker party is unconscionable."). The cost allocation provisions in Option One's arbitration agreement are oppressive and would deter virtually any low or moderate- income litigant (especially one in jeopardy of home foreclosure) from challenging Option One's conduct in the arbitral forum.

Arbitration fees charged by any of the three national arbitration organizations significantly exceed fees associated with any civil action in state or federal court, which creates a significant obstacle for low-income consumers.[15]

In reality, consumers such as Mr. Salley cannot afford the extensive up-front costs associated with private arbitration. As such, the arbitration provision is unconscionable as a matter of law. See Parilla, 368 F.3d at 284; Alexander v. Anthony Int'l, L.P., 341 F.3d 156, 263 (3d Cir. 2003). Option One cannot distinguish its cost-allocation provision from the "fee-splitting" provisions repeatedly deemed unconscionable by courts,[16] merely because Mr. Salley would

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[15] The American Arbitration Association fees include a $1250 filing fee, a "case service fee" of $750, and hourly arbitrators' fees. The National Arbitration Forum fees include a filing fee of approximately $1300, $1750 for initial hearing, $1,500 for each subsequent hearing and $100 for each discovery order sought. JAMS Financial Services Arbitration fees include arbitrator fees of approximately $300 to $500 per hour.

[16] See Spinetti v. Serv. Corp., Int'l, 324 F.3d 212, 217-218 (3d Cir. 2003) (holding "fee-splitting" cost allocation provision of arbitration agreement

maintain a possibility of recovering fees. The distinction is illusory. The Third Circuit has already persuasively reasoned that, "for the purposes of an unconscionability analysis," fee-shifting provisions are as unenforceable as fee-splitting provisions because costs still have to be paid upfront and the recovery of costs is only contingent; because they equally deter low-income plaintiffs from considering suit, they are equally unconscionable. Parilla, 368 F.3d at 284-85.

3. A Finding of Unconscionability Here Is Consistent with Recent Cases Refusing To Uphold Similar Arbitration Agreements Included in Contracts of Adhesion.

The unconscionability of arbitration agreements has been the subject of several recent cases throughout the nation. In Zak v. Prudential Property and Insurance Co., the Superior Court ruled that provisions of an insurance policy were unconscionable because of their effect, even though the language was "facially equal." 713 A.2d 681 (Pa. Super. 1998). In Zak, the unconscionable provisions had the effect of allowing the insurance company access to the courts to appeal an arbitration outcome adverse to it, while binding the consumer to an arbitration outcome adverse to him. Likewise, the arbitration agreement at issue here allows

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unconscionable). See also Ting v. AT & T, 319 F.3d 1126, 1151 (9th Cir. 2003); Bradford v. Rockwell Semiconductor Systems, Inc., 238 F.3d 549 (4th Cir. 2001); Morrison v. Circuit City Stores, Inc., 317 F.3d 646, 669-70) (6th Cir. 2003); Murphy v. Mid-West Life Ins. Co. of Tenn., 78 P.3d 766 (Idaho 2003); Eagle v. Fred Martin Motor Co., 809 N.E.2d 1161 (Ohio App. 2004); Mendez v. Palm Harbor Homes, Inc., 45 P.3d 594, 607 (Wash. App. 2002); Camacho v. Holiday Homes, Inc., 167 F. Supp. 2d 892 (W.D. Va. 2001).

creditors access to the courts to pursue several important creditor remedies, while precluding Mr. Salley from any such access for any claims he has.

A recent decision in Pennsylvania also addressed the unconscionability of an arbitration agreement that prohibited class actions. See Thibdeau v. Comcast, No. 4523, (Pa. Com. Pl. Jan., 24, 2006). Reasoning that the arbitration agreement served to "immunize large corporations from liability," the court held that "[t]he preclusion of classwide litigation or classwide arbitration of consumer claims, imposed in a contract of adhesion, is unconscionable and unenforceable." Id. See also Klussman v. Cross Country Bank, 36 Cal. Rptr. 3d 728 (Cal. App. 1st Dept. 2005) (denying motion to compel arbitration because under state contract law the arbitration provision is unconscionable and therefore unenforceable).

In Ting v. AT&T, the Ninth Circuit found the arbitration agreement in question to be both procedurally and substantively unconscionable. 319 F.3d 1126 (9th Cir. 2003). The arbitration agreement at issue was procedurally unconscionable because it was drafted by the corporation and imposed upon consumers "without opportunity for negotiation, modification or waiver." Id. at 1149. Similarly, the Ninth Circuit found substantive unconscionability because even though the language of the agreement was facially neutral, its effect was one-sided and unreasonably favorable to the drafter. Id. at 1149-53.

These cases demonstrate that courts must weigh not only the language of an arbitration agreement but, more importantly, assess its effect on the parties. Consistent with the above cases, where the arbitration agreement serves to restrict a consumer's practical ability to vindicate his legal rights, without encumbering the rights of the drafter, the arbitration agreement is unconscionable and unenforceable. In other words, if the arbitration provision operates, in practice, as a procedural or economic bar to realistic avenues of dispute resolution for the consumer, while providing all the avenues and practical remedies a creditor would want, it unreasonably favors the creditor, and is unconscionable. In this respect, context is important. Although a split-forum may be acceptable in certain commercial contexts, in the context of subprime mortgage lending it operates as a bar to consumer vindication of loan origination and servicing claims, and is unfairly one-sided.

B. THE ARBITRATION AGREEMENT IS UNENFORCEABLE AS A WHOLE BECAUSE ITS PROBLEMATIC PROVISIONS ARE TOO PERVASIVE AND CENTRAL TO BE SEVERED.

The unconscionable provisions of the arbitration clause here cannot be severed because severance of either of the categorically unconscionable provisions ("split forum" and cost allocation) would undermine the primary purpose of the agreement and defeat public policy. As a result, the Court should deem the entire agreement unenforceable.

Under Pennsylvania contract law, an unconscionable arbitration agreement invalidates the entire contract if the arbitration agreement is not independent of the provisions sought to be severed. Carll v. The Terminix Int'l Co., 793 A.2d at 925-26. As this Court recently held, there is "no bright line rule" for determining severability of contract provisions. Jacobs v. CNG Transmission Corp., 565 Pa. 228, 239, 772 A.2d 445, 452 (2001). "[A] court may look to the contract as a whole, including the character of the consideration, to determine the intent of the parties as to severability and may also consider the circumstances surrounding the execution of the contract, the conduct of the parties, and any other factor pertinent to ascertaining the parties' intent." Id.; see also Heilwood Fuel Company v. Manor Real Estate Company, 405 Pa. 319, 175 A.2d 880 (1961) (finding that absent separate consideration, the contract provisions could not be severed).

Here, the unconscionable provisions that combine to require Mr. Salley to litigate identical claims against related (and cooperating) defendants in two forums (the "split forum" effect) cannot be severed because they form the core of the arbitration agreement. The only way to cure the unconscionability produced by the provision here is to strike the foreclosure exemption, which would effectively re-write the baseline arbitration provision and arguably bind a party or parties who have been assigned the note. Such a re-draft would so fundamentally alter the nature of the written provision as to go well beyond reformation and effectively impose by judicial fiat a different "agreement." If the foreclosure exemption were struck, Option One would no doubt waive arbitration, suggesting that the entire arbitration agreement as currently drafted is unenforceable.

In addition, and independent of the arguments regarding unseverability of the split-forum provisions, the unconscionable cost provisions in the arbitration agreement also cannot be severed. To do so would undermine public policy against enforcing contract provisions that deter future litigants from vindicating important rights. Consistent with this Court's holdings in Jacobs v. CNG Transmission Corporation and Heilwood Fuel Company v. Manor Real Estate Company, the enforcement of a contract with unconscionable provisions does not depend on merely on a court's ability to mechanically separate those provisions. Rather, a court should determine whether partial enforcement would violate public policy or bring injustice to the parties. In the exercise of its equitable powers in this case, Amici urge the Court to engage in a similarly thorough consideration of the interests at stake.

As a practical matter, after striking the cost provision, the only way the remainder of the Agreement could be saved (leaving aside the problems with split forum that also render the entire Agreement unenforceable) would be for a court to equitably order one of the parties to pay for the arbitration. Because of Mr. Salley's indigence, only Option One could be so ordered. However, such a purportedly equitable remedy would produce the very same unfairness that Option

One attempted to create through its unilateral, post-contract-formation offer to pay Mr. Salley's arbitration costs; namely, deterring future litigants from bringing claims against Option One. Exercising equitable powers, therefore, this Court should not consider such a remedy.

Moreover, simply severing this one provision does not provide a sufficient disincentive for Option One to change its practices. Option One will continue including the unconscionable cost provisions in its agreements, in contravention of the public interest, because the worst that could happen is that a court might equitably order them to pay arbitration costs – something they are obviously willing to do on the rare occasions when the provision is challenged. Meanwhile, in the vast majority of subsequent cases the existence of the provision on the face of the agreement will discourage any litigation or arbitration at all. By contrast, if Option One knows that its continued use of this unconscionable cost provision will result in the inability to arbitrate at all, it is far more likely to discontinue its use of them. Only that result is consistent with the public interest.

Severance of the cost provisions, therefore, is an insufficient response to Option One's inclusion of such grossly unfair terms, ones that are deliberately constructed to avoid judicial review of predatory lending practices. See 17A Am. Jur. 2d Contracts § 319 (explaining that the "illegality taints the entire contract" when "the agreement is an integrated scheme to contravene public policy").

CONCLUSION

For the foregoing reasons, this Court should rule that that arbitration agreement at issue in this case is unconscionable in its entirety and therefore unenforceable.

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Respectfully submitted,

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