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# Arbitration clauses in mortgages: Flores v Transamerica HomeFirst, 2001

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## *Flores v Transamerica HomeFirst, 2001*
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**Procedurally and substantively unconscionable arbitration clause in reverse mortgage was unenforceable.**

*Flores v Transamerica HomeFirst, Inc.* (2001) 93 CA4th 846, 113 CR2d 376

Two years after an elderly couple obtained a reverse mortgage from a mortgage company, they sold the home and discovered that, under the terms of the loan agreement, they owed not only the principal and interest from the loan, but also $75,000 in "contingent interest," which represented 50 percent of the market-value appreciation over the loan period. The couple paid under protest and sued the lender for unlawful business practices and other tortious conduct. The lender petitioned to compel arbitration based on the arbitration clause. The trial court refused to compel arbitration.

The court of appeal affirmed, finding the arbitration clause both procedurally and substantively unconscionable, following the precedent of *Armendariz v Foundation Health PsychCare Servs., Inc.* (2000) 24 C4th 83, 99 CR2d 745. The agreement was procedurally unconscionable as a contract of adhesion, imposed on the couple on a "take it or leave it" basis. The agreement was also substantively unconscionable as it did not display even a "modicum of bilaterality." Under the agreement, the borrowers had to arbitrate "any controversy," but the lender could proceed by judicial or nonjudicial foreclosure, self-help, or injunctive relief. The court noted that the agreement allowed the lender to proceed with foreclosure even while arbitration was pending. Rejecting the lender's argument that the Federal Arbitration Act (9 USC §§1–16) precluded a determination that the arbitration agreement was unenforceable, the court held that generally applicable contract defenses, such as unconscionability, may be applied to invalidate arbitration clauses without contravening the Act.

▶***THE EDITOR'S TAKE:*** I suppose it is inevitable that when a provision in a standard form document is held invalid as lacking a "modicum of bilaterality," one naturally asks what additional bilaterality would be sufficient to rehabilitate the clause. The easy general answer is to give the complaining party some of the same rights and powers that the contract gives to the offending party. Thus, if *A* must give three days' notice before exercising his remedies against *B*, *B* should have to give the same three days' notice to *A* before exercising her remedies.

The problem with that easy solution, however, is that it cannot remotely fit a mortgage loan transaction, either factually or legally. Factually, a mortgage loan—once it has been made—is inevitably a unilateral rather than a bilateral contract. The lender has performed its part: It has advanced the money to the borrower and now there is nothing else for it to do except for incidental clerical-type matters, such as rendering regular accountings as to what was paid and reconveying title when the loan has been paid in full. The exchange of the note and the loan funds may be concurrent events, but the actual performance that the lender has bargained for does not occur until the borrower later pays the lender back. The disputed issue in this particular loan transaction—the amount required to pay off the loan—involved only the borrowers' performance; the borrowers' contention was not that the lender had not performed (*i.e.*, failed to make the loan it promised to make), but that the lender's past performance—namely, inclusion of the note's contingent interest provision—had been illegal. No matter how despicable the lender's conduct may have been, it did not constitute a breach of contract such as the lender might claim if the borrowers had failed to pay the contingent interest.

Legally, rather than factually, the imbalance is even more extreme. Absent the arbitration clause, if the lender did anything wrong, the borrower had recourse to any and all remedies that the legal system provided for that wrong. On the other hand, if the borrowers were in the wrong, no similar panoply of remedies existed for the lender. Under California's "one-action" rule of CCP §726, the only remedy available to the lender was foreclosure; the legal and equitable remedies of damage actions, injunctions, etc., were all precluded by virtue of this statute. (Technically, their preclusion is subject to the following qualifications: Under the customary provisions of a trust deed, a lender can elect a nonjudicial trustee sale under the power-of-sale clause or get a court to appoint a receiver under the rents clause, despite the one-action rule; even the existence of some independent noncontractual remedy, such as an action in waste, may be treated as a violation of the one-action rule, or at least to require that a foreclosure sale be completed first. Additionally, because this was a nonrecourse loan, any other monetary relief, such as a deficiency judgment, was also barred, although probably there were carve-out provisions modifying this.)

So how in this context do you provide for a modicum of bilaterality? The only two alternatives necessarily consist of either giving the borrowers some additional nonarbitration remedies on the one hand, or mandating some arbitration remedies against the lender on the other.

From the borrowers' side, that means carving out some claims that they could litigate rather than arbitrate. For example, could the arbitration clause apply to only some kinds of monetary claims (such as the amount of interest charged) but not to others (such as the amount paid back)? Would any such distinction make sense or be upheld as nonarbitrary? The court stated that the lender had the remedies of foreclosure, setoff, and receivership, but a provision in the deed of trust giving the borrower the same remedies would be ludicrous. Why would a borrower ever need to foreclose or set off or have a receiver appointed when it already has received the loan funds from the lender?

Expanding the arbitration clause's coverage against the lender seems equally futile, in light of the one-action rule. Trustee sales do not go before judges anyway, so what would be gained by providing that such proceedings be taken to arbitrators. (*Could an arbitrator order foreclosure???)*

From where I sit, under the logic of this decision, it looks as though arbitration clauses are unsalvageable, no matter how they are worded. —*Roger Bernhardt*