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A Decision to Arbitrate in the Mountain State: The West Virginia Supreme Court of Appeals Rejects Retroactive Application of the Dodd-Frank Act and Enforces Mandatory Arbitration Agreement in Residential Mortgage

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The West Virginia Supreme Court of Appeals recently issued a decision addressing mandatory arbitration in connection with a residential mortgage loan that will impact litigants in the Mountain State and potentially influence cases beyond its borders. In a putative class action entitled *State of West Virginia ex rel. Ocwen Loan Servicing, LLC v. The Honorable Carrie Webster, Judge of the Circuit Court of Kanawha County, West Virginia; Robert L. Curry and Tina M. Curry, Individually and on behalf of a Similarly Situated Class ("Curry")*,[1] the Court considered whether the federal Dodd-Frank Act's prohibition of mandatory arbitration agreements in residential mortgage loans[2] could be applied retroactively to an arbitration agreement entered into almost four years before the Dodd-Frank Act was enacted. The few courts that had previously addressed the retroactivity of related arbitration prohibitions contained in the Dodd-Frank Act had reached conflicting outcomes. Addressing the issue head on, the highest appellate court in the state of West Virginia has now stated its view that the Dodd-Frank Act's arbitration prohibition does not apply to a residential mortgage executed prior to its enactment.[3] The Court then found the arbitration agreement at issue, and the class action wavier included therein, valid and enforceable under West Virginia state law.

Background:

When the plaintiffs obtained their mortgage loan, they executed an arbitration agreement that broadly applies to all claims related to the loan, including claims against subsequent loan servicers. The arbitration agreement also includes a class action waiver, which prohibits the plaintiffs from bringing any loan-related claims on a class basis and requires them to arbitrate any such claims on an individual basis only. Some five years after the origination of their loan, the plaintiffs filed a putative class action in state court in Kanawha County, West Virginia, against the servicer of their loan, Ocwen Loan Servicing, LLC ("Ocwen"). In their Complaint, the plaintiffs allege that certain default-related fees allegedly charged on their loan violated the West Virginia Consumer Credit and Protection Act – a statute that includes substantial civil penalties for each individual violation.[4]

In response to the lawsuit, Ocwen moved to compel individual arbitration on the ground that the issues raised by the plaintiffs' complaint fell within the scope of the mandatory arbitratio agreement and thus required the plaintiffs to submit their claims to individual arbitration. On

this basis, Ocwen requested that the Court either dismiss the complaint or otherwise stay the litigation pending arbitration.

The state trial court denied Ocwen's motion to compel individual arbitration. In doing so, the trial court concluded that the Dodd-Frank Act's arbitration prohibition applied retroactively and thus rendered the arbitration agreement unenforceable under federal law. Putting aside Dodd-Frank, the trial court alternatively held that the arbitration agreement was both procedurally and substantively unconscionable, and thus unenforceable, under West Virginia state law. Thereafter, Ocwen filed a Petition for a Writ of Prohibition (effectively a request for an interlocutory appeal) with the West Virginia Supreme Court of Appeals seeking an order prohibiting the enforcement of the trial court's denial of Ocwen's motion to compel individual arbitration.[5]

The West Virginia Supreme Court of Appeals Decision:

Taking up Ocwen's Petition for a Writ of Prohibition, the West Virginia Supreme Court of Appeals unanimously reversed the trial court on all grounds, found the subject arbitration agreement enforceable under federal and state law, and ordered the trial court to enter an order compelling arbitration.

The first issue addressed by the *Curry* Court was whether Dodd-Frank's prohibition of arbitration provisions in residential mortgages, enacted in 2010, applies retroactively to invalidate an arbitration agreement executed in 2006.[6] The Court acknowledged the well-established presumption against the retroactive application of statutes affirmed repeatedly by the U.S. Supreme Court. Because the relevant provision of the Dodd-Frank Act does not expressly or impliedly state that its provisions are to have retroactive effect, the West Virginia Supreme Court of Appeals, following U.S. Supreme Court guidance, considered whether the enforcement of the arbitration prohibition "'would have a retroactive consequence in the disfavored sense of affecting substantive rights, liability or duties [on the basis of] conduct arising before [its] enactment.'"[7]

The federal district courts that have previously addressed the retroactive application of similar provisions of the Dodd-Frank Act have split on the issue.[8] While a few courts have concluded that similar arbitration provisions of Dodd-Frank are merely jurisdictional and do not affect parties' substantive rights,[9] the *Curry* Court, after analyzing the authority on both sides of the split, concluded that "the more reasoned approach . . . acknowledges arbitration as primarily a contractual matter and that retroactive application of the Dodd-Frank Act to render a properly executed arbitration agreement unenforceable would 'fundamentally interfere with the parties' contractual rights and would impair the predictability and stability of their earlier agreement.'"[10] As such, the Court reversed the trial court, concluding unequivocally that Dodd-Frank's arbitration prohibition does not apply to the contractual arrangement between the plaintiffs and Ocwen (or to other similar arbitration agreements executed before the enactment of Dodd-Frank).[11]

Having found that the Dodd-Frank Act did not bar enforcement of the arbitration agreement, the *Curry* Court next addressed the enforceability of the arbitration agreement under West Virginia state law. The trial court had held that the arbitration agreement was procedurally

and substantively unconscionable, and thus unenforceable, under West Virginia state law.[12] The Supreme Court of Appeals disagreed with both findings.

First, the Court found that the arbitration agreement is not procedurally unconscionable.[13] The Court relied primarily on the fact that the named plaintiffs were advised in writing, in clear and conspicuous language, at the time that they signed the arbitration agreement that they could reject the arbitration provision and still obtain mortgage financing.[14] The Court also noted that the plaintiffs failed to present any evidence that "they lacked sophistication and financial knowledge to a degree that [might] render[] the contract unenforceable," suggesting that a mere imbalance in bargaining power does not render an arbitration agreement procedurally unconscionable in all cases.[15]

Second, the *Curry* Court found that the arbitration agreement is not substantively unconscionable, and rejected each of the trial court's contrary findings.[16] The Court, relying on its own precedent and recent U.S. Supreme Court precedent, dispatched with the trial court's finding that the class action waiver provision renders the contract substantively unconscionable.[17] The *Curry* Court then quickly rejected the remaining findings of the trial court, holding that the arbitration agreement's mutual prohibition on the recovery of attorneys' fees in arbitration, the potential limits on available discovery in arbitration, and the limited exclusion from arbitration for certain foreclosure-related actions did not support the trial court's substantive unconscionability ruling.[18] On these grounds, the West Virginia Supreme Court of Appeals found the arbitration agreement enforceable under West Virginia state law and ordered the trial court to enter an order compelling arbitration.

Conclusion:

The West Virginia Supreme Court of Appeals' decision in *Curry* is significant for at least two reasons. First, it represents the first reported decision of a state's highest appellate court addressing the retroactivity of the Dodd-Frank Act's prohibition of arbitration agreements in connection with residential mortgage loans. While the Court's decision does not apply beyond the borders of the Mountain State, the Court's analysis and ultimate holding may serve as persuasive authority for state and federal courts throughout the country that may be presented with the same issue.

Second, the *Curry* Court's decision signals continued acceptance of arbitration agreements under West Virginia state law. The enforceability of any arbitration agreement is generally dependent upon the particular terms of the agreement and the circumstances in which the parties entered the arbitration agreement. Thus, each decision is necessarily fact-specific. Nevertheless, in the years leading up to *Curry*, the West Virginia Supreme Court of Appeals had strictly applied its unconsionability analysis to mandatory arbitration agreements in consumer-related contracts such that, more often than not, it concluded that the agreements at issue were not enforceable under state law. Several recent arbitration-related decisions in West Virginia, including *Curry*, appear to reflect a shift in that trend. K&L Gates will continue to monitor these issues in West Virginia, and similar arbitration-related issues before federal and state courts across the country.

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[1] *State ex rel. Ocwen Loan Servicing, LLC v. Webster*, --- S.E.2d ---, 2013 WL 6050723 (W. Va. Nov. 13, 2013) (Opinion Granting Petition for a Writ of Prohibition). A copy of the West Virginia Supreme Court of Appeals Opinion granting Ocwen's Petition for Writ of Prohibition is also available on the West Virginia Supreme Court of Appeals' website at http://www.courtswv.gov/supreme-court/opinions.html.

[2] *See* 15 U.S.C. § 1639c(e)(1) ("No residential mortgage loan . . . secured by the principal dwelling of the consumer may include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.") (codifying amendments to the federal Truth-in-Lending Act).

[3] Based on our research, the West Virginia Supreme Court of Appeals is the first appellate-level court, and the first state supreme court, to directly address and adjudicate the Dodd-Frank retroactivity issue.

[4] *See* W. Va. Code §§ 46A-2-115(s), 127(d), 127(g), and 128(c); *see also* W. Va. Code §§ 46A-5-101(1), 106 (authorizing recovery of civil penalties for violations of the West Virginia Consumer Credit and Protection Act).

[5] At the time that Ocwen filed its Petition for a Writ of Prohibition, West Virginia state law did not provide for an immediate and direct appeal of a decision denying a motion to compel. Notably, however, after Ocwen

filed its petition, the West Virginia Supreme Court of Appeals affirmatively held that a party may directly appeal from a decision denying a motion to compel. *See Curry*, 2013 WL 6050723, at p. 3, n. 2.

[6] The *Curry* Court did not address Ocwen's argument that the Dodd-Frank Act's arbitration prohibition did not become effective until, at the earliest, January 21, 2013. In light of the *Curry* Court's holding that the Dodd-Frank Act did not apply retroactively, the Court, as a practical matter, did not need to address this issue. *See Curry*, 2013 WL 6050723, at *4 n.3 (note that the citations to the *Curry* decision herein reference the page number of the printed-out Westlaw version of the decision; at the time of publication the Westlaw style pagination had not yet issued).

[7] *Curry*, 2013 WL 6050723, at p.6 (quoting *Fernandez-Vargas v. Gonzales*, 548 U.S. 30, 37 (2006)).

[8] *See id.* at pp. 6-8 (discussing conflicting case law addressing the retroactivity of arbitration-related provisions of the Dodd-Frank Act).

[9] *See*, *e.g.*, *Wong v. CKX, Inc.*, 890 F. Supp. 2d 411 (S.D.N.Y. 2012); *Pezza v. Investors Capital Corp.*, 767 F. Supp. 2d 225 (D. Mass. 2011).

[10] *Curry*, 2013 WL 6050723, at p. 8 (quoting *Henderson v. Masco Framing Corp.*, No. 7:11-cv-02475, 2011 WL 3022535, at *4 (D. Nev. July 22, 2011) (internal citations omitted)) (citing cases).

[11] *See id.* ("we conclude that retroactive application of the Dodd-Frank Act to the arbitration agreement at issue in this case would improperly impair the parties' fundamental right to contract").

[12] While the arbitration agreement at issue is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, *et seq.*, the FAA provides that an arbitration agreement may be rendered unenforceable under certain state law defenses applicable to all contracts, such as unconscionability. *See* 9 U.S.C. § 2 ("A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*." (emphasis added)).

[13] *See Curry*, 2013 WL 6050723, at pp. 10-11 ("Based on our examination of the arbitration agreement, we find no basis upon which to conclude that it is procedurally unconscionable.").

[14] *See id.* at p. 10.

[15] *Id.* at p. 11.

[16] *See id.* at pp. 11-17.

[17] *See id.* at pp. 11-13.

[18] *See id.* at pp. 13-17.