BE CAREFUL WHAT YOU WISH FOR (PART II): FOURTH CIRCUIT INVALIDATES ARBITRATION PROVISION WHICH WAS NOT GOVERNED BY APPLICABLE LAW

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Arbitration is popular alternative dispute resolution mechanism, which allows parties to structure litigation in a manner that theoretically streamlines the process, cuts costs, and helps them obtain an expeditious resolution of a dispute. However, a party's ability to structure an alternative dispute resolution mechanism is not without limits. For example, the decision of the Fourth Circuit Court of Appeals in *Heyes v. Delbert Services Corp.*, 2016 WL 386016 (4th Cir. Feb. 2, 2016) demonstrates the importance of drafting contracts that comply with applicable law.

Western Sky is an online lending company based out of the Cheyenne River Indian Reservation in South Dakota. Western Sky issued a payday loan to James Heyes, the lead plaintiff, and charged Heyes an interest at a rate of 139.12%. Other named plaintiffs were charged a similar, interest rate, and one was even charged an annual interest rate of 233.84%. There was no question that the applicable interest rate violated state and federal lending laws.

To try to avoid the consequences of the illegal nature of the loans at issue, Western Sky drafted provisions in its lending agreements in an attempt to shield itself from applicable usury laws. Among other provisions, the lending documents stated that the agreement is "subject solely to the exclusive laws and jurisdiction of the Cheyenne River Sioux Tribe," and that "no other state or federal law or regulation shall apply to this Loan Agreement." 2016 WL 386016 at *2. The lending agreements also contained an arbitration provision which provided in relevant part that "any dispute [the borrower] ha[s] with Western Sky or anyone else under this loan agreement will be resolved by binding arbitration," and that the arbitration "will be conducted by the Cheyenne River Sioux Tribal Nation by an authorized representative in accordance with its consumer dispute rules and the terms of this agreement." *Id.* at *3. The arbitration provision further provided a borrower with the right to "select the American Arbitration Association ("AAA"), Judicial Arbitration and Mediation Services ("JAMS") or another organization to administer the arbitration." *Id.*

Notwithstanding the language of the lending agreement and the arbitration provision, Heyes and other borrowers from Western Sky filed a series of lawsuits against it alleging a large number of violations of applicable federal and state law. Western Sky sought to dismiss the lawsuits and compel arbitration. The district court granted Western Sky's motion to dismiss and compelled arbitration, based primarily on its finding that because parties had recourse to well-recognized arbitration organizations, the arbitration clause was enforceable. Heyes timely filed an appeal.

On appeal, the Fourth Circuit accepted Heyes's argument that the arbitration provision at issue was unenforceable because it "sets up a hollow arbitration mechanism." 2016 WL 386016 at *4. Specifically, the Fourth Circuit found that no applicable law would apply to the arbitration procedures set forth in the arbitration

provision, rendering it unenforceable as a matter of law. The Fourth Circuit also found that the arbitration provision was invalid because it purported to renounce the wholesale application of any federal law to the plaintiffs' federal claims. In determining that the arbitration provision at issue was unenforceable, the Fourth Circuit noted that while the Federal Arbitration act gives parties the ability to structure arbitration in the way they chose, such freedom does not extend to a substantive waiver of federally protected civil rights.

The *Heyes* decision reflects the importance of ensuring that contract provisions comply with applicable laws. Even though a party can waive certain rights by contract, such a waiver will not be enforced where it runs contrary to applicable law.

For more information on this topic, please contact the author, Zach Hyman, on the firm's Business Reorganization and Dispute Resolution Teams.

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