THE HONORABLE ROBERT J. BRYAN

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

TERESA TITUS, as an individual and as a representative of the class,

Plaintiff,

vs.

ZESTFINANCE, INC., BLUECHIP FINANCIAL, and DOUGLAS MERRILL,

Defendants.

No. 3:18-cv-05373-RJB

PLAINTIFF'S RESPONSE TO DEFENDANTS' MOTIONS TO COMPEL ARBITRATION AND TO DISMISS OR STAY PROCEEDINGS HEREIN

Oral Argument Requested

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INTRODUCTION

The plaintiff in this case, Teresa Titus, is a Washington resident who was lured into obtaining payday loans from Spotloan—an online lending website created and run by the defendants in this case, BlueChip Financial, ZestFinance and Douglas Merrill. Even though Washington caps interest rates on loans at 12%, Ms. Titus's carried triple-digit interest rates that ranged from 390% to 490%. All told, under the Spotloan lending scheme, Ms. Titus's $3,000 in loans put her on the hook for about $7,500—more than double what she borrowed. Although Washington regulators have informed Spotloan that its lending violates Washington law, it continues to peddle its illegal loans to Washington residents.

The two motions now before this Court concern the enforceability of efforts by the Spotloan affiliates to contract their way out of legal accountability. To evade courts and regulators, they did their lending over the Internet and sought to cloak themselves in immunity from all federal and state law through a "tribal-arbitration" clause that, by its terms, expressly disavows the application of all federal and state law to any dispute and specifically forbids an arbitrator from applying any of the federal or state laws governing a consumer's claims. This type of contract has been called an "integrated scheme to contravene public policy" and a "brazen" attempt to avoid federal and state lending and consumer-protection laws. *Hayes v. Delbert Servs. Corp.*, 811 F.3d 666, 674, 676 (4th Cir. 2016). And it is invalid under the Federal Arbitration Act: An arbitration contract that "attempt[s] to apply tribal law to the exclusion of federal and state law" is "unenforceable as a matter of law." *Dillon v. BMO Harris Bank, N.A.*, 856 F.3d 330, 336 (4th Cir. 2017).

The defendants nevertheless insist that the arbitration clause must be enforced. They claim that courts have "repeatedly" enforced similar tribal-arbitration contracts "when plaintiffs

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have asserted similar claims against tribal corporations or their related entities." BlueChip Motion at 6. That is wrong. "[E]very Court of Appeals that has considered" a tribal-arbitration contract has found it entirely unenforceable and "refused to dismiss the case or compel arbitration." *Smith v. Western Sky Fin. LLC*, 168 F. Supp. 3d 778, 781 (E.D. Pa. 2016). The Fourth Circuit has twice labeled these sorts of tribal-arbitration contracts a "farce," designed specifically "to avoid state and federal law," and deployed by lenders "to game the entire system." *Hayes*, 811 F.3d at 674, 676; *Dillon*, 856 F.3d at 337. And other circuits have likewise refused to enforce them multiple times. *See Parnell v. Western Sky Fin. LLC*, 664 Fed. App'x 841 (11th Cir. 2016); *Parm v. Nat'l Bank of Cal.*, 835 F.3d 1331 (11th Cir. 2016); *Inetianbor v. CashCall, Inc.*, 768 F.3d 1346, 1354 (11th Cir. 2014); *Jackson v. Payday Fin., LLC*, 764 F.3d 765 (7th Cir. 2014).

There is more. Since the Fourth Circuit's path-marking decision in *Hayes*, the district courts have (with one cursory exception) *unanimously* invalidated these contracts under the FAA because they purport to strip a consumer's federal and state statutory rights. *See Rideout v. CashCall, Inc.*, 2018 WL 1220565 (D. Nev. Mar. 8, 2018); *MacDonald v. CashCall, Inc.*, 2017 WL 1536427 (D.N.J. Apr. 28, 2017), *affirmed* 883 F.3d 220 (3d Cir. 2018); *Ryan v. Delbert Servs. Corp.*, 2016 WL 4702352 (E.D. Pa. Sept. 8. 2016); *Gingras v. Rosette*, 2016 WL 2932163 (D. Vt. May 18, 2016); *Smith*, 168 F. Supp. 3d at 784–85; *but see Banks v. CashCall, Inc.*, 188 F. Supp. 3d 1296 (M.D. Fla. 2016) (failing to even cite *Hayes*).

The defendants have chosen not to cite, let alone discuss, any of this relevant adverse authority—an ongoing problem in these tribal-arbitration cases. *See Smith*, 168 F. Supp. 3d at 781 (noting the defendants' "selective presentation of cases"). Instead, they pretend as if enforcement entails little more than a straightforward application of a settled line of cases enforcing tribal-arbitration clauses. But the very cases on which they rely have been repeatedly rejected by the

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federal circuits—a point that goes completely unacknowledged in the defendants' briefs. That omission alone is enough to justify denial of the motions. A party that "tiptoe[s] around a central issue" in its opening brief—whether "the omission was intentional or merely negligent"—commits "a significant error" that should not be sanctioned. *Brown v. Rawson-Neal Psychiatric Hosp.*, 840 F.3d 1146, 1149 (9th Cir. 2016) (applying forfeiture).

Regardless, the Spotloan contract here cannot be enforced. Doing so would require departing from the Fourth Circuit and the near-uniform consensus of the district courts since *Hayes*. And it would also require holding that an arbitration contract requiring consumers to prospectively waive their rights must be enforced. But under the FAA, "courts will not enforce" a set of provisions "forbidding the assertion of certain statutory rights," whether "in an arbitration agreement or any other contract." *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228, 236, 241 (2013). The FAA may indeed be designed to facilitate legitimate dispute resolution, but it does not tolerate a party "underhandedly convert[ing]] a choice of law clause into a choice of no law clause." *Hayes*, 811 F.3d at 675. Here, the Spotloan affiliates drafted an arbitration clause "in a calculated attempt to avoid the application of state and federal law," and so the "entire arbitration agreement is unenforceable"—it "contravene[s] public policy" and takes a step "forbidden" by the FAA. *Dillon*, 856 F.3d at 334, 337. The motions to compel arbitration should be denied.

BACKGROUND

1. The Spotloan rent-a-tribe lending scheme. BlueChip Financial, known to the public as "Spotloan," is an online lender that sells low-dollar, high-interest loans over the internet to thousands of consumers across the country. *See* Compl. ¶ 28. In a typical loan, a consumer borrows several hundred dollars but has to repay the loan at triple-digit interest rates that can

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easily end up doubling or tripling the total dollar amount ultimately owed on the loan. *See, e.g.*, *Hayes*, 811 F.3d at 668–69 (describing the basic rent-a-tribe lending strategy). Spotloan holds itself out as a tribal entity associated with North Dakotan Tribe, the Turtle Mountain Band of Chippewa Indians. But Spotloan is a front—the consumer-facing website of a rent-a-tribe scheme that is the brainchild of former Google Chief Information Officer Douglas Merrill and his company ZestFinance. Compl. ¶¶ 28–42; *see generally* Heather L. Petrovich, *Circumventing State Consumer Protection Laws: Tribal Immunity and Internet Payday Lending,* 91 N.C. L. Rev. 326 (2012).

Merrill's foray into online lending began after he claimed to have developed new "big-data credit-scoring tools" for payday lending. *See* Mikella Hurley & Julius Adebayo, *Credit Scoring in the Era of Big Data*, 18 Yale J. L. & Tech. 148, 164 (2016) ("*Credit Scoring*"). After leaving Google, Merrill began raising millions from Silicon Valley investors, including $20 million from "a group led by PayPal billionaire Peter Thiel" for a new payday lending venture. *See* John Lippert, *ZestFinance issues small, high-rate loans, uses big data to weed out deadbeats*, The Washington Post (Oct. 11, 2014), *available at* https://wapo.st/2Msbht3. This funding allowed Merrill, and his company ZestFinance, to begin offering small-dollar loans that "feature[d] extremely high rates of interest." *Credit Scoring*, 18 Yale J. L. & Tech. at 164, n. 71. A typical $600 or $800 loan carried an annual interest rate of up to 390%—"at least four times the subprime credit card rates offered by some banks." Lippert, *supra*, *available at* https://wapo.st/2Msbht3; *see also* www.spotloan.com/how-spot-loans-work.

But Merrill and ZestFinance, which initially offered these loans through an entity called ZestCash, had a problem: Because payday loans often trap consumers in a "vicious cycle of indebtedness," *Johnson v. Cash Store*, 116 Wash. App. 833, 68 P.3d 1099, 1105–06 (2003),

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most states require lenders making small-dollar short-term loans to be licensed. Quentin Hardy, *Big Data for the Poor*, The New York Times (July 2, 2012) *available at* https://nyti.ms/2OEfgQK. ZestFinance "spent years" trying, without much success, to obtain state-approved lending licenses. *Id.* (explaining that only "a few states" had licensed ZestFinance's lending). That was unsurprising: the loans carried triple-digit interest rates that vastly exceeded state usury laws, which typically cap interest rates at somewhere between 7% and 24%. *See* Usury Laws by State, *available at* http://www.loanback.com/category/usury-laws-by-state.

ZestFinance's inability to obtain state lending licenses might have led to the "failure of the company's business model," had it not been for the emergence of the rent-a-tribe lending scheme. Hardy, *supra*, *available at* https://nyti.ms/2OEfgQK. In this now-familiar enterprise, a non-tribal lender creates an "intentionally complicated and sham" lending structure that purports to offer loans through a tribal entity but in reality is "nothing more than a front" to enable the non-tribal lender "to evade licensure by state agencies and to . . . shield its deceptive business practices from prosecution by state and federal regulators." *In re CashCall, Inc.*, 2013 WL 3465250, at *3 (N.H. Banking Dept. June 4, 2013).

In 2012, Merrill and ZestFinance replaced their original lending model with a rent-a-tribe scheme. Zestcash was rebranded as "Spotloan" and Merrill and ZestFinance undertook "a relationship with a Native American tribe to circumvent state payday lending and usury laws." *See* Americans for Financial Reform, *Private equity piles into payday lending and other subprime consumer lending* (Dec. 2017), *available at* https://bit.ly/2NrA80H. And, after Spotloan was up and running as a purported tribal lender, they boosted the annual interest-rate ceiling on the loans by 100 points—from 390% to 490%. *See id.* (highlighting Spotloan rates of 490%); *see also* Compl. ¶ 28.

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As alleged in the Complaint, the Spotloan lending structure looks like this: At Merrill and ZestFinance's direction, the Turtle Mountain Band of Chippewa Indians—a federally recognized tribe located in Belcourt, North Dakota—created a wholly-owned tribal entity, Bluechip Financial, which immediately began making loans under the "Spotloan" name. Compl. ¶¶ 33–35. But although Spotloan purportedly made the loans, ZestFinance and Merrill provided the infrastructure to market, fund, underwrite, and collect on the loans. *Id.* ¶ 36. The Tribe receives only a very small percentage of the profits from Spotloan's lending activities. *Id.* ¶ 40.

2. Ms. Titus's loans. Ms. Titus typifies the sort of consumer on which Spotloan preys. A 60-year-old grandmother, she has been physically disabled much of her adult life. Although she has found work sporadically—for a time she worked as a paralegal and also as a bookkeeper—most of her income comes from Social Security Disability benefits. Compl. ¶ 45. After freeing herself from an abusive relationship, Ms. Titus moved from her native California to Washington in 2005, bought land in Ridgefield, and then built a house. *Id.* ¶ 46. Ultimately, though, she fell behind on her mortgage payments and that is when Spotloan entered the picture. *Id.* ¶¶ 47–50.

After searching online, Ms. Titus found Spotloan's webpage and, on December 7, 2015, applied for a loan. Compl. ¶ 50. She was approved the same day and, one day later, "Spotloan DB" deposited $800 into her account. *Id.* ¶ 52. The loan carried an annual interest rate of 390%, which meant that, to pay it off, Ms. Titus would owe $1,787.88. *Id.* Several months after first taking out the $800, Ms. Titus had paid the defendants nearly $1,500. *Id.* ¶ 54.

Spotloan then allowed Ms. Titus to take out a second loan, and then a third, and then a fourth. *Id.* ¶ 55. These loans carried even higher interest rates—topping out at 460%. All told, for $3,000 in loans, Ms. Titus paid Spotloan $5,976.04, incurring $105 in overdraft fees for her Spotloan payments.

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3. Financial regulators repeatedly try to crack down on Spotloan. In the several years since the inception of the Spotloan lending scheme, financial regulators have repeatedly attempted to crack down on it. In 2016, for instance, the chief financial regulator in Illinois issued a cease and desist order to Spotloan and Bluechip Financial. *See* Declaration of Beth E. Terrell ("Terrell Decl."), Ex. A. Although the state never authorized Spotloan to issue loans in Illinois and did not issue a license to the company to "offer, make, or arrange" short term loans to consumers in the state, an investigation revealed that Spotloan was doing just that. As a result, Spotloan was found to have violated multiple state lending laws and was ordered to cease and desist "offering, making, or arranging" any loans in the state and collecting on any loans already made. *Id.* at 4.

And just last year, the Washington Department of Financial Institutions issued a warning to the enterprise after receiving a report that Spotloan had been "making threats" against Washington consumers about the collection of certain loans. *See* Terrell Decl., Ex. B. The state regulator made clear that Spotloan and its "associated businesses" are "not licensed" to lend in the state and "are not registered to conduct business" in Washington. And the agency explained that, under Washington State law, it is illegal for "an unlicensed entity" to make any "small loan" to "a person physically located in Washington State." *Id.* Nevertheless, Spotloan continues—to this day—to offer its loans to Washington consumers. *Id.*, Ex. C.

4. Ms. Titus sues the Spotloan enterprise. In an effort to curtail ZestFinance and its affiliates' unlawful conduct, Ms. Titus brought a proposed class action against ZestFinance, Bluechip Financial, and Douglass Merrill individually. *See generally* Compl. (Dkt. No. 1). The interest rates that Spotloan charges Washington consumers for its loans blatantly exceed the maximum allowable interest rate of 12% per year set by Washington's usury law. RCW

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19.52.020. A violation of Washington's usury law is a per se violation of Washington's Consumer Protection Act. *See* RCW 19.86.020; RCW 19.52.036. What's more, Spotloan also deceptively uses the tribe as a front and a shield for its usurious lending practices and falsely represents to consumers that state law does not apply to their loans. These acts all violate the CPA's provisions prohibiting unfair or deceptive acts occurring in trade and commerce. *See* RCW 19.86 *et seq.*

Accordingly, Ms. Titus has asserted violations of various Washington and federal laws related to the illegal loans offered by Spotloan and its affiliated entities. *See id.* ¶¶ 66–110 (asserting common-law claims for unjust enrichment, and statutory claims for violations of Washington's usury law, RCW 19.52.030, the Washington Consumer Protection Act, RCW 19.86, and civil RICO, 18 U.S.C. § 1961 et seq.). And she seeks damages, reimbursement, and injunctive relief on behalf of herself and several classes of consumers who received similar loans. *Id.* § 10.

5. The defendants attempt to shield their scheme from scrutiny. Like other rent-a-tribe lending schemes, Spotloan is part of a contractual web of liability shields—an integrated (and sometimes inconsistent) set of choice-of-law provisions, forum-selection clauses, and arbitration requirements—deployed, as the Fourth Circuit recently put it, to "game the entire system." *Hayes*, 811 F.3d at 676. And, although there is no "serious[] dispute" that these sorts of loans "violate[] a host of state and federal laws," *Id.* at 669, Spotloan (like other rent-a-tribe enterprises) premises its lending scheme on the theory that it can avoid liability by cloaking its activities in tribal immunity. *See generally Williams v. Big Picture Loans, LLC*, __ F. Supp. 3d __, 2018 WL 3615988 (E.D. Va. July 27, 2018) (describing the basic theory of arm-of-the-tribe immunity and rejecting its application to the rent-a-tribe lending context because the "real purpose" of these enterprises is to help non-tribal entities "avoid liability").

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To begin, the Spotloan contracts expressly require borrowers to relinquish their rights under state and federal law. The contract contains several clauses purporting to establish complete tribal jurisdiction for, and require the exclusive application of tribal law over, any claims arising out of a Spotloan loan transaction. It states that "This Agreement shall remain exclusively subject to the laws and courts of the Turtle Mountain Band of Chippewa Indians." Dkt. No. 28-1 at 9.[1] And another clause likewise provides:

> **Governing Law.** Spotloan is organized under the laws of the Turtle Mountain Band of Chippewa Indians (the "Tribe"). Your Loan Agreement becomes a binding contract with us when we accept it at our offices on the Turtle Mountain Indian Reservation. By Signing this Loan Agreement, you agree that the laws of the Tribe will apply to the Loan Agreement, and understand that United States state law does not apply to the Loan Agreement in any way. You also agree to be subject to the jurisdiction of the Tribe.

Dkt. No. 28-1 at 5.

These exclusive tribal-law and tribal-forum requirements are coupled with a demand that any dispute over the legality of the loans be resolved in arbitration, not court. The contracts say that "[a]ny dispute under this Agreement will be decided under the terms set forth in the Binding Arbitration and Jury Trial Waiver below." *Id.* And the terms of the relevant "Binding Arbitration" clause provide that, although a party may "select the American Arbitration Association ("AAA")," "JAMS," or another "Arbiter in good standing with an arbitration group" to arbitrate a dispute, any arbitrator (regardless of provider) is expressly forbidden from applying any rules or law that would "conflict" with the contract. *See id.* at 7 (stating that, although "[t]he Arbiter must arbitrate under AAA or JAMS consumer rules," "[a]ny rules that conflict with any of our agreements with you don't apply"); *id.* (requiring that the "Arbiter must enforce your agreements with us, as they are written").

[1] Unless otherwise noted, record citations are to page numbers assigned by the Court's ECF system.

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The arbitration clause also contains several other provisions. It states that it covers "all claims even indirectly related to your application and agreements with us" and includes "extensions, renewals, refinancings, or payment plans" as well as "claims related to collections, privacy, and customer information." Dkt. No. 28-1 at 6. It also purports to cover "claims related to setting aside this Clause," "claims about the Clause's validity and scope," and "claims about whether to arbitrate." *Id.* In addition, the arbitration clause prohibits class actions, permits a party to opt-out in writing, and purports to cover "any third parties related to any Dispute." *Id.* at 5, 6, 7.

Based on these provisions, the defendants have now moved to force this case out of court and into arbitration. *See generally* Dkt. No. 30.

ARGUMENT

I. The arbitration agreement is unenforceable because, by its terms, it forbids the application of state and federal law.

The defendants' effort to compel arbitration fails for one simple reason: by its terms, their contract ensures that, no matter who the arbitrator is or where the arbitration occurs, the federal and state law governing a consumer's claims may not be applied. That is forbidden. Although the FAA has a broad reach, "courts will not enforce a prospective waiver" of statutory rights, "whether in an arbitration agreement or any other contract." *Italian Colors*, 570 U.S. at 241. Over the past two years, this rule has been consistently applied by federal circuit and district courts alike to invalidate similar efforts by rent-a-tribe lenders to enforce tribal-arbitration contracts that disavow state and federal law. These courts have delivered an unmistakable message: When a lender drafts an arbitration contract "in a calculated attempt to avoid the application of state and federal law," the "entire arbitration agreement is unenforceable." *Dillon*,

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856 F.3d at 335, 337. Under this rule, the defendants' contract is invalid and the motions to compel must be denied.

A. The contract is invalid under the FAA because it prospectively waives a consumer's state and federal statutory rights.

As the Supreme Court has repeatedly made clear, a contract that operates "as a prospective waiver of a party's right to pursue statutory remedies" is unenforceable. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985); *see Italian Colors*, 570 U.S. at 235. Under this "prospective waiver" doctrine, courts will not enforce an arbitration agreement if doing so "would prevent a litigant from vindicating federal substantive statutory rights." *Dillon*, 856 F.3d at 334. An arbitration contract is invalid under this "fundamental" rule where it undertakes a "categorical rejection of the requirements of state and federal law." *Hayes*, 811 F.3d at 668, 673; *see Dillon*, 856 F.3d at 334.

The defendants' contract here straightforwardly violates this prohibition. It provides that any dispute shall be "exclusively subject to the laws and courts of the Turtle Mountain Band of Chippewa Indians" and that only "the laws of the Tribe will apply to the Loan Agreement." Dkt. No. 28-1 at 9, 5. And it requires that any arbitrator—regardless of who it is—"must enforce" this mandate "as written"—forbidding the application of any rules that would "conflict" with the contract. Dkt. No. 28-1 at 7. Because that language renounces "the application of federal or state law" to a consumer's claims and directs that "the arbitrator shall not allow for the application of any law other than tribal law," the "entire arbitration agreement is unenforceable." *Dillon*, 856 F.3d at 335–37 (internal quotations omitted); *see also Hayes*, 811 F.3d at 669–71, 675 (holding

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that a tribal-arbitration contract is unenforceable under the FAA where it "names a tribal forum and then purports to disavow the authority of all state or federal law").[2]

The relevant language here is indistinguishable in substance from other tribal-arbitration cases. In *Hayes*, for instance, the tribal loan contract included a choice-of-law provision stating that the contract "shall be governed by the law of the Cheyenne River Sioux Tribe" and then elsewhere asserted that it was "subject solely to the exclusive laws and jurisdiction of [the Tribe]." *Id.* at 669, 670. That language was then coupled with an arbitration clause that disclaimed the application of "any law other than the law of the Cheyenne River Sioux Tribe of Indians" and required the arbitrator to "apply the laws of the Cheyenne River Sioux Tribal Nation and the terms of this Agreement" to any claims. *Id.* at 670; *see also id.* at 673. And in *Dillon*, a different tribal-arbitration contract stated that it "shall be governed by the law of the Otoe-Missouria Tribe of Indians" and required any arbitrator to "apply the laws of the Otoe-Missouria Tribe of Indians and the terms of this Agreement." 856 F.3d at 335.

The Fourth Circuit invalidated these contracts in their entirety. Tribal-arbitration contracts that reject the requirements of state and federal law and forbid an arbitrator from even applying the applicable law constitute a "brazen" attempt "to achieve through arbitration what Congress has expressly forbidden." *Hayes*, 811 F.3d at 676 (quoting *Graham Oil v. ARCO Prods. Co.*, 43 F.3d 1244, 1249 (9th Cir. 1994)). As the Fourth Circuit has explained, the FAA does not permit a company to "free" itself of the strictures of federal and state law. *Id.* To the contrary, an arbitration agreement may not, "[w]ith one hand," offer "an alternative dispute

[2] Other clauses in the contract reinforce the point. For instance, another provision provides that "United States state law does not apply to the Loan Agreement in any way." Dkt. No. 28-1 at 9. That language is patterned on a similar clause in *Dillon*, which stated that "[n]either this Agreement nor the Lender is subject to the laws of any state of the United States." 856 F.3d at 336. And it does not matter that this sort of clause omits the phrase "federal law" from its scope—as *Dillon* explains, because the contract elsewhere stated that it was exclusively subject to tribal law, its rejection of both federal and state law was unambiguous. Just so here.

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resolution procedure in which aggrieved persons may bring their claims," and "with the other, [] proceed[] to take those very claims away." *Hayes*, 811 F.3d at 673–74. To violate the FAA, the contract does not need to explicitly prohibit an arbitrator from applying federal or state law—that is, it need not specifically say "that the arbitrator shall not allow for the application of any law other than tribal law." Instead, so long as it uses a choice-of-law provision and arbitration clause to waive a consumer's federal and state statutory rights, it is invalid. *See Dillon*, 856 F.3d at 335–36 (explaining that a contract that "attempt[s] to apply tribal law to the exclusion of federal and state law" "implicitly accomplishes" a prospective waiver and is therefore invalid). Were it otherwise, the "just and efficient system of arbitration intended by Congress when it passed the FAA" would be made to "play host" to arbitration schemes designed "to game the entire system." *Hayes*, 811 F.3d at 674–76 (concluding that such a contract "represents an 'integrated scheme to contravene public policy'").

The gamesmanship in this case extends even to the defendants' effort to ensure that the FAA itself applies. Consider: If the contract states that it is exclusively subject to the laws of the Tribe, then a federal court would not have jurisdiction under the FAA to even issue an order compelling arbitration and an arbitrator would not have any authority under the FAA to decide threshold questions of arbitrability or conduct an arbitration. *Gibbs v. Plain Green, LLC*, 2018 WL 4186399, at *4–5 (E.D. Va. Aug. 31, 2018) (noting the tribal payday lender's "attempts to have it both ways" by arguing that the Court "lacks subject matter jurisdiction over the controversy as a whole, but somehow retains subject matter jurisdiction for the limited purpose of compelling arbitration" and finding such a position "contrary" to Supreme Court precedent "and to common sense"). To avoid this problem, the defendants here inserted a clause (1) stating that the FAA applies and (2) requiring an arbitrator to "apply the substantive law consistent with the

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FAA," thus crafting a single FAA-specific exception to the contract's disavowal of federal law. Dkt. No. 28-1 at 6. That doesn't change the outcome here, but it does illustrate how this contract is rigged.

And the presence of a delegation clause—a provision designed to allow an arbitrator to decide certain threshold questions concerning the contract's enforceability—does not change this result either. A contract that contains an FAA-prohibited prospective waiver is unenforceable in its entirety, delegation clause included. "In practical terms, enforcing the delegation provision would place an arbitrator in the impossible position of deciding the enforceability of the agreement *without* authority to apply any applicable federal or state law." *Smith*, 168 F.3d at 786 (emphasis in original). As a result, any delegation clause in the defendants' contract is unenforceable "for virtually the same reason" that the rest of the arbitration contract is unenforceable. *MacDonald*, 2017 WL 1536427, at *4; *Parm*, 835 F.3d at 1338 (invalidating *both* the delegation clause *and* the underlying arbitration agreement because the contract violates the FAA and is "integral to the parties' agreement to arbitrate"); *Parnell*, 664 Fed. App'x at 843–44 (same); *Hayes*, 811 F.3d at 671 n.1 (same).

The upshot: Because the FAA "does not protect" tribal-arbitration contracts that "attempt to apply tribal law to the exclusion of federal and state law," the "the entire arbitration agreement" is unenforceable. *Dillon*, 856 F.3d at 336–37 (refusing to compel arbitration of both federal RICO or state-law usury and consumer-lending claims). The motions to compel should therefore be denied.

B. The older district court cases cannot overcome the overwhelming consensus that has emerged since *Hayes*.

In pressing their view that the contract is enforceable, the defendants fail to cite, let alone address, even one of the directly relevant federal appellate decisions. Instead, they claim that

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"courts have repeatedly enforced arbitration agreements when plaintiffs have asserted similar claims against tribal corporations or their related entities," and point to some district court cases that, save one, were all decided before the Fourth Circuit's decision in *Hayes*. *See* BlueChip Motion (Dkt. No. 27) at 6 (citing seven pre-*Hayes* district court cases involving identical or nearly identical contracts as the one invalidated in *Hayes*). (Although *Banks v. CashCall* was decided several months after *Hayes*, the court did not acknowledge *Hayes* and, like the others, did not address the fundamental flaws in the contract. *See* 188 F. Supp. 3d 1296, 1302–04 (M.D. Fla. 2016)).

But none of these cases considered or discussed the basic rule that, under the FAA, arbitration contracts that name a tribal forum and disavow the applicability of state or federal law are "unenforceable as a matter of law" because they prospectively waive a claimant's statutory rights. *Dillon*, 856 F.3d at 334. And none of these cases properly read or interpreted the plain language of the contracts themselves. Indeed, the defendants in *Hayes* and *Dillon* relied on these very same cases, to no avail. *See* Corrected Brief of Appellee/Cross-Appellant (Doc. 44) at 23–28, *Hayes v. Delbert Servs. Corp.*, 811 F.3d 666 (4th Cir. 2016) (Nos. 15-1170, 15-1217) (arguing, among other things, that "[t]he rulings in *Kemph*, *Williams*, and *Chitoff*" are "persuasive"); Joint Opening Brief of Defendant-Appellants (Doc. 32) at 57, n. 18, *Dillon v. BMO Harris Bank, N.A.*, 856 F.3d 330 (4th Cir. 2017) (No. 16-1362) (citing the same cases and arguing that "district courts have enforced the arbitration provision . . . at issue here"). The Fourth Circuit had little difficulty rejecting them.

One example illustrates the problem. In *Yaroma*—the first tribal-arbitration case cited by the defendants here—the district court concluded that, although the contract required the exclusive application of tribal law, it was nonetheless enforceable because the defendants later

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"agreed" that "federal law . . . could be used instead" and assured the court that "[t]he final decision about which law to apply would be left to the arbitrator." *See Yaroma v. Cashcall, Inc.*, 130 F. Supp. 3d 1055, 1064–65 (E.D. Ky. 2015).

That logic, however, fails for the simple reason that arbitration agreements must be "enforced according to their terms." *Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 682 (2010) (internal quotations omitted). Although "there is [a] presumption in favor of arbitration, '[t]he courts are not to twist the language of the contract to achieve a result which is favored by federal policy but contrary to the intent of the parties.'" *Parm*, 835 F.3d at 1335. In every one of these tribal-arbitration cases, as *Hayes* and *Dillon* make clear, the plain terms of the contract leave no room for doubt—they "unambiguous[ly] attempt to apply tribal law to the exclusion of federal and state law" and as a result function as an invalid and unenforceable prospective waiver. *Dillon*, 856 F.3d at 336.[3]

The plain text of the defendants' contract forecloses any reliance on these flawed and outdated cases here. An arbitration agreement "does not, in the context of litigation, become [an] opening bid in a negotiation . . . over the agreement's unconscionable terms." *Nino v. Jewelry Exch., Inc.*, 609 F.3d 191, 205 (3d Cir. 2010). Instead, where a company drafts the agreement, it is "saddled with the consequences of the [contract] as drafted." *Id.* (internal quotations omitted). And where an agreement's illegal provisions constitute the "primary" or "essential" purpose of the arbitration, *id.* at 206 (quoting the Restatement), courts will not reward that illegality by

[3] Some defendants have suggested that district courts should defer ruling on the legality of tribal-arbitration contracts until after an arbitration has occurred. *See, e.g.*, *Dillon*, 856 F.3d at 335 (explaining that the defendants "urge[] us to defer consideration of the prospective waiver doctrine until after the arbitrator construes the choice of law provision and decides whether any federal remedies remain available"). But waiting until the award enforcement stage is only appropriate where there is "uncertainty regarding the effect of the choice of law provision." *Dillon*, 856 F.3d at 335; *see also Vimar*, 515 U.S. at 540–41. When it comes to these tribal-arbitration contracts, "there is no uncertainty." *Dillon*, 856 F.3d at 335. The contract here "effects an unambiguous and categorical waiver of federal statutory rights" and so it is unenforceable at the threshold. *Id.*; *cf. Jackson*, 764 F.3d at 779 (refusing to defer consideration until after arbitration because the contract "provides that a decision is to be made under a process that is a sham from stem to stern").

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enforcing a stripped-down version of the agreement. *See, e.g.*, *Graham Oil*, 43 F.3d at 1248–49 (holding that multiple illegal provisions tainted the entire purpose of the arbitration agreement); *see also Gandee v. LDL Freedom Enters., Inc.*, 176 Wash. 2d 598, 239 P.3d 1197, 1202 (2013) (refusing to enforce an arbitration clause overrun by unconscionable terms because "[p]arties should not be able to load their arbitration agreements full of unconscionable terms" and then be permitted to offer to waive or agree to striking them to save the arbitration agreement). When it comes to these tribal-arbitration contracts, because the choice-of-law provisions are "essential to the purpose of the arbitration agreement," any attempt to "consent" to the application of federal or state law "would defeat the purpose of the arbitration agreement in its entirety." *Dillon*, 856 F.3d at 336.

So it is here. Because this contract, like the others, requires the application of tribal law to the exclusion of federal and state law, the only way it can pass muster under the FAA is to ignore or sever those offending provisions. But doing that would require a court to "rewrite the unenforceable foreign choice of law provision in order to save" it. *Id.* The FAA does not permit this. "It is a well-known principle" that "a clause cannot be severed from a contract when it is an integrated part of the contract." *Graham Oil*, 43 F.3d at 1248. And that is especially true where, as here, the "offending parts" of the contract "do not merely involve a single, isolated provision," but instead comprise a "highly integrated unit" that "establishes a unified procedure for handling disputes." *Id.* It is therefore "untenable" to rewrite a tribal-arbitration contract to allow for the application of federal or state law because the exclusive tribal-choice-of-law provisions are "purposefully drafted" by the defendants "to avoid the application of state and federal consumer protection laws." *Dillon*, 856 F.3d at 336; *see also Rideout*, 2018 WL 1220565, at *7 (refusing to sever because the "offending provisions go to the core of the arbitration agreement" and

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observing that it would be "farcical" to allow the defendant to "unilaterally and retroactively decide what portions of a contract may be enforced").

These basic points are reinforced by what has happened since *Hayes*. Unlike those cases cited by the defendants, the district courts that have confronted similar contracts in the wake of the relevant appellate authority have, with near unanimity, refused to enforce them. "It is difficult to imagine," one post-*Hayes* district court remarked, "a more transparent attempt to hijack the FAA to deprive aggrieved parties of an opportunity to meaningfully adjudicate their claims" than by employing a tribal-arbitration contract that—by its terms—repeatedly "ensures that no matter who the arbitrator is . . . federal and state law may not be applied." *MacDonald*, 2017 WL 1536427, at *5–6.

Other recent courts have reached the same conclusion. *See, e.g.*, *Rideout*, 2018 WL 1220565, at *6 (refusing to enforce tribal-arbitration contract because it "has chosen the only type of forum—tribal law—that exists in all states that could effect a waiver of federal statutory rights"); *Ryan*, 2016 WL 4702352, at *5 (holding that "the wholesale waiver of federal and state law . . . dooms both the delegation provision and the arbitration clause"); *Smith*, 168 F. Supp. 3d at 785 (holding that this arbitration agreement is completely unenforceable because its "purpose" is not "to create a fair and efficient means of adjudicating Plaintiff's claims, but to manufacture a parallel universe in which state and federal law claims are avoided entirely"). Consistent with this weight of authority, this Court should invalidate the defendants' arbitration contract in its entirety.

C. The choice-of-law clause, standing alone, does not save the contract.

Although the defendants opt not to address any of the key authority in their motion to compel, their case for enforcement rests on the claim that the tribal-choice-of-law provisions reflect little more than a choice to allow some foreign law to govern the agreements. *See*

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BlueChip Motion (Dkt. No. 27) at 7 (arguing that Washington courts "generally enforce choice of law provisions" and that this Court should do so here). But no court facing a rent-a-tribe contract has bought this theory, and for good reason: these contracts go well beyond the mere choice of foreign law.

In *Hayes*, the defendants pressed the same theory—that their contract reflected nothing more than a choice to be bound by tribal, not federal or state, law—and the Fourth Circuit rejected it. "[P]arties are free within bounds to use a choice of law clause in an arbitration agreement to select which local law will govern the arbitration," the court explained, "[b]ut a party may not underhandedly convert a choice of law clause into a choice of no law clause—it may not flatly and categorically renounce the authority of the federal statutes to which it is and must remain subject." *Hayes*, 811 F.3d at 675.

To be effective, a foreign choice-of-law clause cannot "wholly [] displace American law even where it otherwise would apply." *Mitsubishi Motors*, 473 U.S. at 637 n.19. Instead, all it may do is "select[] the law of a certain jurisdiction to govern the agreement." *Hayes*, 811 F.3d at 675 (emphasis added). Under this settled approach, so long as the arbitration agreement does not explicitly eliminate a claimant's right to bring a statutory claim, its choice of foreign law should not be disturbed. *See, e.g.*, *Schnall v. AT&T Wireless Servs., Inc.*, 171 Wash. 2d 260, 259 P.3d 129 (2011) (enforcing contractual choice-of-law provision in ruling on contract claims, but not on Washington Consumer Protection Act claims).

But the flip side of this rule is just as true: a choice-of-law provision that "expressly forfeits" a claimant's statutory rights is unenforceable as a matter of law. *Graham Oil*, 43 F.3d at 1247. That is precisely what the defendants' contract seeks to do: "instead of selecting the law of a certain jurisdiction to govern the agreement, as is normally done with a choice of law clause,"

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the arbitration contract "uses its 'choice of law' provision to waive all of a potential claimant's federal rights." *Hayes*, 811 F.3d at 675. The tribal-choice-of-law-clause is therefore unenforceable.

That is why the substance of the Tribe's law does not affect the application of this rule. As *Dillon* makes clear, a contract that "attempt[s] to apply tribal law to the exclusion of federal and state law" is unenforceable "as a matter of law," regardless of any alternative remedies that might be available under tribal law. *Dillon*, 856 F.3d at 336. A contract, in other words, that does not allow an arbitrator "to consider *any* of the claims that [a consumer] asserts in her Complaint since the arbitrator would be prohibited from applying the relevant law" is invalid because, on its face, it "gut[s]" the laws that "would otherwise control." *Smith*, 168 F. Supp. 3d at 785. And here, the law that controls Ms. Titus's substantive claims it *not* tribal law. *See, e.g.*, *Jackson*, 764 F.3d at 783 (rejecting any suggestion that a contractual tribal-forum-selection clause can confer tribal-subject-matter jurisdiction over a nonmember's consumer-protection claims); *MacDonald*, 2017 WL 1536427, at *8–10 (rejecting any effort to apply tribal law to a consumer's state consumer-protection and usury claims).

Indeed, Washington courts *would not* enforce the contract's tribal-choice-of-law provisions, even assuming those provisions were valid. For instance, the Washington Supreme Court has squarely held, in cases involving alleged violations of the state's usury laws brought by Washington residents, that a choice-of-law provision selecting any foreign law is invalid. *Whitaker v. Spiegel Inc.*, 95 Wash. 2d 408, 623 P.2d 1147, 1151 (1981) (citing RCW 19.52.034 and refusing to enforce a choice-of-law clause selecting Illinois law because "the legislature has directed that, in an action brought in Washington on an allegedly usurious transaction, Washington's usury laws will apply"). And Washington courts have likewise refused enforcement

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of arbitration clauses that are drafted for the purpose of denying Washington citizens remedies for consumer protection violations. *See Mendez v. Palm Harbor Homes, Inc.*, 111 Wash. App. 446, 45 P.3d 594, 605 (2002) (explaining that "avoiding the public court system in a way that effectively denies citizens access to resolving everyday societal disputes is unconscionable" and instructing that any goal of "favoring arbitration of civil disputes must not be used to work oppression").

Of course, some defendants in these tribal-arbitration cases have suggested that Chapter 2 of the FAA, which implements the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, could support a contrary conclusion. *See, e.g.*, *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528 (1995); *Aggarao v. MOL Ship Mgmt. Co., Ltd.*, 675 F.3d 355 (4th Cir. 2012); *Lindo v. NCL (Bahamas) Ltd.*, 652 F.3d 1257 (11th Cir. 2011). But if the defendants decide to press this argument in reply, it will be foreclosed because the contract at issue here is not governed by Chapter 2 or the Convention. *See* 9 U.S.C. § 202 (establishing the conditions for applicability). It is therefore not subject to the Convention's specific framework for evaluating the enforceability of Chapter 2 contracts. *See Aggarao*, 675 F.3d at 372–73 (explaining how international-comity concerns inform the enforceability analysis of arbitration contracts governed by the Convention). Not surprisingly, the Fourth Circuit did not see this framework as compelling a different result in the rent-a-tribe lending context. *See, e.g.*, *Dillon*, 856 F.3d at 334 (acknowledging this argument and holding it inapplicable).

II. ZestFinance's and Merrill's effort to enforce this arbitration contract demonstrates how it is designed to circumvent federal and state law.

In their separate motion to compel arbitration, ZestFinance and Douglass Merrill—the architect of the Spotloan lending scheme—make clear that this arbitration contract was specifically drafted with both ZestFinance and Merrill in mind. The "arbitration provisions," they say

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"equally govern" the claims against them because the contract "expressly" covers them. ZestFinance/Merrill Motion, Dkt. No. 30 at 2, 8–9. That, they insist, means that the Court's "analysis can and should stop here." *Id.* at 2. Indeed it should. Because the agreement expressly purports to deprive consumers of the availability of federal and state law, it is unenforceable across the board—including in its application to any third parties like ZestFinance and Merrill. Suffice to say that both *Hayes* and *Dillon* (not to mention nearly all of the district court cases since) involved similar third parties who sought—unsuccessfully—to cloak themselves in the protections of a tribal-arbitration agreement that prospectively waived federal and state law.

ZestFinance's and Merrill's effort to force the claims against them into tribal arbitration, though, affords a clearer picture of the true design of the rent-a-tribe scheme. Like every other rent-a-tribe lender, neither ZestFinance nor Merrill can "seriously dispute" that the loans at issue in this case "violate a host of state and federal lending laws"—indeed, a "quick glance" at the contract suggests that all the defendants here are "keenly aware of the dubious nature of [the] trade." *Hayes*, 811 F.3d at 669. What's more, Spotloan has been notified by several states that its loans are illegal, and ZestFinance's move to establish a rent-a-tribe lending model followed directly on the heels of its years-long, failed effort to secure state lending licenses.

But the rent-a-tribe lending strategy only works if every related entity can circumvent state payday lending and usury laws. Here, ZestFinance and Merrill, despite being intimately involved in the Spotloan enterprise, do not, because they cannot, contend that they are members of the Tribe or make any formal "claim of tribal affiliation." *Hayes*, 811 F.3d at 673. And they do not "attempt to ground [their] renunciation of federal law" on the theory that they are tribal entities "and therefore not subject to the authority of federal law." *Id.* That leaves only one reason they seek to enforce this contract: it would shield them from federal and state law and free them from

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any meaningful accountability. Such an effort is, to say the least, not "on the up-and-up," *id.* at 676, and exposes the "purpose" of the tribal-arbitration contract for what it is: an attempt "not to create a fair and efficient means of adjudicating [a consumer's] claims, but to manufacture a parallel universe in which state and federal law claims are avoided entirely." *Smith*, 168 F. Supp. 3d at 785. Because such a contract is not enforceable under the FAA, these defendants' motion to compel arbitration should be denied.[4]

RESPECTFULLY SUBMITTED AND DATED this 10th day of September, 2018.

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[4] In two perfunctory paragraphs, the defendants reserve defenses related to sovereign immunity and personal jurisdiction. *See* Dkt. No. 27 at 11 (BlueChip reservation of sovereign immunity defense); Dkt. No. 30 at 13–14 (ZestFinance/Merrill reservation of personal jurisdiction defense). We, of course, reserve the right to respond fully to those arguments if and when they are properly raised, as recent courts facing similar efforts have already rejected them. *See, e.g., Williams*, 2018 WL 3615988, at *15–24 (concluding that tribal lenders did not qualify for arm-of-the-Tribe immunity and therefore were "not immune from suit" because, among other things, they were formed to avoid liability); *Inetianbor v. CashCall, Inc.*, 2016 WL 4250644, at *8–9 (S.D. Fla. Apr. 5, 2016) (rejecting similar personal-jurisdiction arguments under RICO where the defendant was a "primary participant" in allegedly unlawful lending scheme that targeted forum residents). In any event, these reservations, and the issues they involve, are irrelevant for purposes of the current motions.

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