CONTRACT LAW — FORCED ARBITRATION — THIRD CIRCUIT RULES THAT TRIBAL PAYDAY LENDERS CANNOT COMPEL ARBITRATION. — *Williams v. Medley Opportunity Fund II, LP*, 965 F.3d 229 (3d Cir. 2020).

When signing a contract for a cell phone plan, a bank account, or a short-term loan, few individuals, if any, take the time to read the fine print.[1] But often buried in this fine print are arbitration clauses that waive the consumer's right to bring a suit in court. Instead, the consumer is forced into arbitration — a process in which a "neutral" individual, often chosen by the company, will hear the dispute.[2] Arbitration clauses typically ban class actions, forcing individuals to bring their claims alone and often creating such a large barrier to suit that the case isn't worth pursuing at all.[3] Recently, in *Williams v. Medley Opportunity Fund II, LP*,[4] the Third Circuit refused to enforce an arbitration clause in a payday loan contract when a tribe-affiliated lender attempted to restrict the arbitration to only tribal law claims.[5] Relying on the "prospective waiver" doctrine,[6] the court held that such a choice-of-law provision unlawfully prevented the plaintiffs from vindicating their federal rights through arbitration.[7] *Williams* thus represents an important practical victory for consumers, although the court's reliance on a narrower choice-of-law issue revealed the need to expand the doctrine to capture the actual economic realities of payday loan borrowers.

Pennsylvania residents Christina Williams and Michael Stermel decided to search for payday loans they could easily obtain via the internet.[8] In this search, they came across AWL, Inc., an online lender owned by the Oklahoma-based Otoe-Missouria Tribe of Indians.[9] The loans they ultimately received had principal amounts that ranged from $1,000 to $1,600, with annual percentage interest rates (APR) that ranged from 496.55% to 714.88%.[10] In the process of applying for the loans, Williams

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[1] *See* Yannis Bakos, Florencia Marotta-Wurgler & David R. Trossen, *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. LEGAL STUD. 1, 2 (2014).

[2] *See* Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES (Oct. 31, 2015), https://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html [https://perma.cc/BVQ5-XRZN].

[3] *See* Scott Medintz, *Forced Arbitration: A Clause for Concern*, CONSUMER REPS. (Jan. 30, 2020), https://www.consumerreports.org/mandatory-binding-arbitration/forced-arbitration-clause-for-concern [https://perma.cc/L78D-6WQF]; Silver-Greenberg & Gebeloff, *supra* note 2.

[4] 965 F.3d 229 (3d Cir. 2020).

[5] *Id.* at 244.

[6] *See id.* at 238.

[7] *Id.* at 241.

[8] *See id.* at 233.

[9] *Id.*

[10] *Id.* at 234 n.2.

and Stermel signed loan agreements that contained information including "interest rates, payment terms, and other provisions."[11] Each loan agreement stated, in multiple places, that only tribal law would apply.[12] Each loan agreement also provided that any disputes arising from the agreement would be resolved by binding arbitration.[13] The contracts stated: "This [Loan] Agreement shall be governed by Tribal Law."[14] This subsection of the contract then read: "[T]he arbitrator shall apply Tribal Law and the terms of this [Loan] Agreement, including [the arbitration agreement]."[15]

On behalf of a class of borrowers, Williams and Stermel sued both AWL's holding company and several members of AWL's board of directors, asserting that the lender charged "unlawfully high interest rates."[16] The plaintiffs alleged that the defendants violated several Pennsylvania state laws and the Racketeer Influenced and Corrupt Organizations Act[17] (RICO) — a federal law.[18] They also argued that the arbitration agreement could not be enforced because it restricted the plaintiffs' ability to invoke federal and state statutory rights, making the contract "a farce designed to avoid state and federal law."[19] In response, the defendants asked the court to compel arbitration,[20] asserting that the arbitration agreement in the loan contracts was enforceable.[21]

The district court denied the defendants' motion to compel arbitration.[22] The court emphasized that while the Federal Arbitration Act[23] (FAA) is indeed broad in scope, it cannot be used to avoid compliance with federal law by permitting only tribal law claims in an arbitration proceeding.[24] The defendants argued federal law claims were sufficiently available through the contract's provision that "federal law as is applicable under the Indian Commerce Clause" would apply in arbitration, but the district court rejected this claim.[25] Further, the fact that

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[11] *Id.* at 234.

[12] *Id.* at 234–36.

[13] *Id.* at 234–35.

[14] *Id.* at 235 (alteration in original) (capitalization omitted) (quoting Joint Appendix at 291, *Williams*, 965 F.3d 229 (Nos. 19-2058, 19-2082)).

[15] *Id.* (second and third alterations in original) (quoting Joint Appendix, *supra* note 14, at 291).

[16] *Id.* at 233.

[17] 18 U.S.C. §§ 1961–1968.

[18] *Williams*, 965 F.3d at 236. RICO allows criminal prosecution and civil penalties for racketeering performed as part of an ongoing criminal organization or enterprise. *See* 18 U.S.C. §§ 1962–1964.

[19] Williams v. Red Stone, Inc., No. 18-CV-2747, 2019 WL 9104165, at *3 (E.D. Pa. May 7, 2019), *aff'd sub nom.* Williams v. Medley Opportunity Fund II, LP, 965 F.3d 229.

[20] *Williams*, 965 F.3d at 233.

[21] *Id.* at 236–37.

[22] *Id.* at 233.

[23] Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–16).

[24] *Red Stone*, 2019 WL 9104165, at *3.

[25] *Id.*

the contract allowed a choice of two well-known organizations to act as arbitrators in any dispute could not save the agreement;[26] because the arbitration agreement explicitly required the arbitrator to apply tribal law, the choice-of-arbitrator provision was inapposite to the court's analysis.[27] The court reasoned that, regardless of the arbitrator chosen, the arbitrator would have been forced to consider only tribal claims to the exclusion of federal claims.[28]

The Third Circuit affirmed.[29] Before determining whether the motion to compel arbitration should be allowed, Judge Shwartz[30] analyzed the contract's delegation clause to decide whether "the court or the arbitrator" should determine the enforceability of the arbitration agreement.[31] Because the plaintiffs explicitly challenged the delegation clause in their pleadings, the court considered the delegation issue as part of its evaluation of the arbitration agreement's broader enforceability.[32]

The court then analyzed whether the arbitration clause amounted to a prospective waiver of the plaintiffs' rights.[33] The prospective waiver doctrine refers to "a situation in which the parties agree that, if disputes arise between them, then they waive the right to rely on federal law."[34] Drawing on *American Express Co. v. Italian Colors Restaurant*,[35] the court noted that, "while federal policy favors arbitration,"[36] prospective waivers violate public policy because such agreements limit litigants' ability to pursue their statutory rights.[37] In this case, the court found that the arbitration agreement permitted only tribal law claims, to the exclusion of federal law claims.[38] Because the agreement consequently prevented the plaintiffs from vindicating their federal statutory rights, the agreement violated the prospective waiver doctrine.[39]

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[26] *Id.* at *2–3. The contracts in question listed the American Arbitration Association and JAMS as arbitrators. *Id.* at *2.

[27] *Id.* at *3.

[28] *Id.*

[29] *Williams*, 965 F.3d at 244.

[30] Judge Shwartz was joined by Judges Scirica and Cowen.

[31] *Williams*, 965 F.3d at 237.

[32] *Id.* at 237–38.

[33] *Id.* at 238.

[34] *Id.*

[35] 570 U.S. 228 (2013).

[36] *Williams*, 965 F.3d at 238; *see also* Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 FLA. ST. U. L. REV. 99 (2006) (arguing that the FAA was never meant to create such sweeping preference for arbitration as is now supported in federal courts due to the Supreme Court's statutory construction of the Act).

[37] *Williams*, 965 F.3d at 238 (citing Blair v. Scott Specialty Gases, 283 F.3d 595, 605 (3d Cir. 2002)).

[38] *Id.* at 239.

[39] *Id.* at 241.

The Third Circuit also refuted two other arguments posed by the defendants. First, the court noted that, contrary to the defendants' assertion,[40] it would not be sufficient for the plaintiffs to be able to bring a tribal analogue of their federal RICO claim.[41] Second, the court noted that restricting plaintiffs' federal rights to "such federal law as is applicable under the Indian Commerce Clause" would prevent the plaintiffs from bringing their substantive claims because RICO was not passed pursuant to the Indian Commerce Clause.[42] Thus, the court reasoned, the arbitration clause necessarily excluded some federal law and "create[d] an impermissible waiver of federal statutory rights."[43] Because the waiver of statutory rights could not be severed from the arbitration agreement, the court found that the arbitration agreement was unenforceable.[44] The court reasoned that the agreement's reliance on tribal law was "intertwined with the arbitration process and [was] central to it,"[45] noting that, in comparable loan agreements, the reliance on tribal law ensured lenders "could engage in lending and collection practices free from the strictures of any federal law."[46]

Due to Supreme Court precedent, consumers are practically unable to assert their rights in federal court, and instead are usually forced into arbitration. Consequently, *Williams* and cases like it are particularly important because they represent one method of striking down predatory arbitration clauses within the existing doctrine. Largely because of federal court decisionmaking, arbitration has become a key mechanism in restricting the ability of consumers to bring claims against large corporations. Supreme Court jurisprudence, while creating some limits on the ability to bar consumers from effectively accessing justice, has largely permitted aggressive and unfair arbitration practices to continue. By invalidating an arbitration agreement based on its choice-of-law provision, the *Williams* court applied the formalistic holding of *Italian Colors* while creating an important win for consumers. While cases like *Williams* should be celebrated, the narrow applicability of the case does not solve the continued vulnerability of consumers under a formalistic approach to arbitration agreements; a more robust solution would be a more functionalist approach that considers the real impact of forced arbitration in the consumer realm.

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[40] Defendant Red Stone (AWL's holding company) did not assert this argument, which was put forth by the other defendants. *Id.* at 241 n.12.

[41] *Id.* at 241–42.

[42] *Id.* at 242.

[43] *Id.* at 243.

[44] *Id.* at 243–44.

[45] *Id.* at 243.

[46] *Id.* at 244 (quoting Hayes v. Delbert Servs. Corp., 811 F.3d 666, 676 (4th Cir. 2016)).

Nowadays, the practice of inserting arbitration agreements with class action bans into consumer contracts is commonplace, usually to the detriment of consumers like those in *Williams*. Congress enacted the FAA to incentivize businesses with roughly equal bargaining power to resolve problems outside of court.[47] For the past decade, federal courts have interpreted the FAA to apply to consumer contracts as well, with the help of eager corporate lawyers.[48] But in the consumer setting, bargaining power is far from equal, as large corporations with vast resources and legal teams have little incentive to compromise with individual consumers. This imbalance has resulted in both the widespread use of arbitration clauses in consumer contracts — with nearly all payday loan agreements incorporating them[49] — and the near-universal prevalence of class action waivers, forcing consumers to go it alone to vindicate their rights.[50] Forced arbitration in payday lending has an especially pernicious impact because of the vulnerability of these borrowers, making it even more difficult for them to succeed in arbitration.[51] In *Williams*, the court acknowledged this harsh economic reality, beginning the opinion by defining payday loans as "ostensibly short-term cash advances for people who face unexpected obligations or emergencies."[52] While arbitration advocates argue that recent developments, such as corporations paying for arbitration fees, reduce the unfairness of arbitration in the consumer space, arbitration still serves as an effective tool to prevent plaintiffs from challenging corporate malfeasance.[53]

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[47] *See* Moses, *supra* note 36, at 106.

[48] *See, e.g.*, AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 340, 352 (2011) (holding that FAA preempted California Supreme Court rule that had deemed enforcement of class action waivers in arbitration agreements unconscionable); *see also* Silver-Greenberg & Gebeloff, *supra* note 2.

[49] *See* CONSUMER FIN. PROT. BUREAU, ARBITRATION STUDY § 2, at 22 (2015), https://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf [https://perma.cc/R4UF-C9UU].

[50] *See id.* § 1, at 10 (noting that "[n]early all the arbitration clauses" included in the study prohibited class proceedings).

[51] Groups with disproportionately high rates of payday loan borrowing include "those without a four-year college degree; home renters; African Americans; those earning below $40,000 annually; and those who are separated or divorced." SAFE SMALL-DOLLAR LOANS RSCH. PROJECT, PEW CHARITABLE TRS., PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 4 (2012), https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf [https://perma.cc/B6C6-S99W].

[52] *Williams*, 965 F.3d at 234 (quoting Gingras v. Think Fin., Inc., 922 F.3d 112, 117 (2d Cir. 2019)).

[53] *Cf.* Alison Frankel, *California Is on the Verge of a Law to Punish Companies for Stalling Arbitration Fees*, REUTERS (Sept. 24, 2019, 6:15 PM), https://www.reuters.com/article/us-otc-arbitration/california-is-on-the-verge-of-a-law-to-punish-companies-for-stalling-arbitration-fees-idUSKBN1W932T [https://perma.cc/M9J6-P33L] (describing a relatively new and innovative mass action arbitration strategy in the employment realm, wherein "[m]ore than 12,000 [Uber] drivers filed for individual arbitration," and while "Uber was contractually obliged to pay the

Despite the challenges that forced arbitration creates for consumers, the Supreme Court has explicitly upheld the practice. While the Court has consistently affirmed that arbitration agreements must allow "the prospective litigant [to] effectively . . . vindicate [their] statutory cause of action in the arbitral forum,"[54] this principle has been of little practical help to consumers.[55] In *Italian Colors*, the Court held that the FAA permitted a class action arbitration waiver, even though the plaintiff's individual cost of arbitration would effectively prohibit arbitration proceedings.[56] In doing so, the Court severely cabined the utility of its "effective vindication" precedent, stating that "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[57] The latter clearly occurred only when the arbitration agreement included a "prospective waiver" of the consumer's statutory rights.[58] In other words, the Court focused on whether the plaintiffs could formally, or legally, pursue their rights as provided by statutes, not whether they could do so in practice. Scholars have bemoaned the rigidity of *Italian Colors* and the often insurmountable challenges that consumers now face.[59] Because of the protection provided by the Supreme Court, "[i]t has become routine . . . for powerful economic enterprises" to write class arbitration waivers into their consumer contracts.[60]

Despite this corporate-friendly backdrop, the *Williams* court offered a much-needed win for consumers under the doctrine. Drawing on

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fees[,] . . . which meant that Uber was exposed to millions of dollars in fees[,] . . . Uber balked at paying fees in all but a handful of those arbitrations").

[54] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 (1985); *see also id.* at 628; Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 90 (2000) (citing *Mitsubishi Motors*, 473 U.S. at 628).

[55] *See, e.g.*, *Green Tree Fin. Corp.-Ala.*, 531 U.S. at 90–91. *But see* Kristian v. Comcast Corp., 446 F.3d 25, 52–53 (1st Cir. 2006) ("We are left to conclude that . . . the ban on recovery of attorney's fees and costs in the arbitration agreements would burden Plaintiffs here with prohibitive arbitration costs, preventing Plaintiffs from vindicating their statutory rights in arbitration."). *See generally* Stephen E. Friedman, *Trusting Courts with Arbitration Provisions*, 68 CASE W. RSRV. L. REV. 821, 840–43 (2018) (arguing that the Supreme Court has misconstrued the FAA so as to make arbitration enforcement practically automatic).

[56] Am. Express Co. v. Italian Colors Rest., 570 U.S. 228, 231, 233 (2013).

[57] *Id.* at 236.

[58] *Id.*; *see Williams*, 965 F.3d at 242.

[59] *See, e.g.*, Friedman, *supra* note 55, at 843 (describing *Italian Colors* as helping to "place[] arbitration agreements in bubble wrap, immune from all but the narrowest grounds of attack"); Lauren Guth Barnes, *How Mandatory Arbitration Agreements and Class Action Waivers Undermine Consumer Rights and Why We Need Congress to Act*, 9 HARV. L. & POL'Y REV. 329, 352 (2015); J. Maria Glover, *Disappearing Claims and the Erosion of Substantive Law*, 124 YALE L.J. 3052, 3073 (2015) (noting that *Italian Colors* revealed that "[i]n practical terms . . . the only type of provision the Court would acknowledge as being covered by [the prospective waiver doctrine] was a naked exculpatory clause").

[60] DIRECTV, Inc. v. Imburgia, 577 U.S. 47, 59 (2015) (Ginsburg, J., dissenting); *see* Friedman, *supra* note 55, at 842–43.

Italian Colors, the Third Circuit panel reasoned that AWL's choice-of-law provision restricting arbitration to tribal law was equivalent to a "choice of *no* law clause" that prevented the plaintiffs from vindicating their federal statutory rights.[61] While the court explicitly recognized that *Italian Colors*' narrow reading of "effective vindication" enabled prohibitive economic barriers to arbitration,[62] such pragmatic considerations were not required in the court's analysis: because the tribal law provision *formally* barred these federal claims, the agreement fell well within *Italian Colors*' explicit repudiation of prospective waivers.

This decision marked an important consumer-rights victory for two reasons. First, while the direct applicability of *Williams* was admittedly narrow — had AWL not limited the arbitration proceedings to tribal law and the narrow subset of federal laws that are applicable under the Indian Commerce Clause, the contract may have been enforceable — the case still offered protection for many consumers by limiting payday lenders' ability to shield themselves from liability under federal and state laws.[63] Second, *Williams* joined a growing effort by lower courts to protect consumers despite the challenges created by *Italian Colors*.[64] Other circuits have likewise struck down tribal choice-of-law provisions in payday lending contracts,[65] and courts have invalidated arbitration contracts where companies improperly bind nonparties or ineffectively notify online consumers of arbitration clauses, among other issues.[66] These incremental victories provide narrow but meaningful relief to consumers under a doctrine that has otherwise been unforgiving.

A more robust solution than the one provided by *Williams* would be a more functionalist approach to the question of when a "prospective litigant effectively may vindicate" their statutory rights,[67] rather than the formalistic approach currently utilized. A doctrine that acknowledged the economic realities of payday lending and the high costs of arbitration would prevent companies from "us[ing] arbitration to preemptively crush consumer challenges to their practices, no matter

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[61] *Williams*, 965 F.3d at 241 (emphasis added) (quoting Hayes v. Delbert Servs. Corp., 811 F.3d 666, 675 (4th Cir. 2016)).

[62] *See id.* at 242 n.13 (citing *Hayes*, 811 F.3d at 675).

[63] *See* Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?*, 69 WASH. & LEE L. REV. 751, 766–67 (2012) ("There are approximately 35 online cash advance and payday loan companies that are owned by American Indian tribes. Consumers have taken out approximately 12,500 loans over the last year in which these tribes made approximately $420 million." (quoting *The Connection Between Indian Tribes and Payday Lending*, ONLINE CASH ADVANCE, https://fastcashloansrater.com/financial-news/the-connection-between-indian-tribes-and-payday-lending [https://perma.cc/8QUN-4WMU])).

[64] *E.g.*, Chavarria v. Ralphs Grocery Co., 733 F.3d 916, 926–27 (9th Cir. 2013).

[65] *See, e.g.*, Gingras v. Think Fin., Inc., 922 F.3d 112, 127 (2d Cir. 2019); *Hayes*, 811 F.3d at 675.

[66] *See* Barnes, *supra* note 59, at 350.

[67] *Williams*, 965 F.3d at 238, 242 n.13.

how predatory, discriminatory, unsafe — and even illegal — they may be."[68] Courts should be able to focus on the economic realities driving corporations' insistence on using arbitration clauses to prevent consumers from attaining meaningful recourse. Absent a rethinking of *Italian Colors*, Congress is fully capable of amending the FAA to prohibit class action waivers and other aggressive arbitration strategies, and some members have offered such legislative proposals.[69]

Until these approaches gain more traction, the court's decision in *Williams* provides a glimmer of light in the consumer protection world. Payday lending schemes and forced arbitration are designed to prey on vulnerable populations and prevent them from getting any sort of relief from the federal courts.[70] Arbitration has operated for years as a wealth transfer mechanism, shifting power and money from ordinary individuals to increasingly wealthy corporations.[71] Given this country's disturbing history with regard to its treatment of Indigenous peoples, this use of arbitration should raise concerns for both consumer and tribal advocates; while this case may have been a win for consumers, it potentially represented a loss for tribes.[72] This complex tension should encourage consumer advocates to be thoughtful about how protecting consumers can also harm others who have been systemically neglected and disadvantaged by our justice system. By invalidating arbitration clauses using the prospective waiver doctrine, courts allow consumers to file their cases and potentially settle with lenders for meaningful amounts. *Williams* serves as an important lesson on how predatory financial practices can be curbed and consumers can be protected in a world where the federal courts remain formalistically inclined to honor arbitration clauses and legislatures fail to provide relief.

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[68] Medintz, *supra* note 3.

[69] *E.g.*, Press Release, Rep. Hank Johnson, Rep. Johnson Re-introduces Legislation to End Forced Arbitration & Restore Accountability for Consumers, Workers (Feb. 11, 2021), https://hankjohnson.house.gov/media-center/press-releases/rep-johnson-re-introduces-legislation-end-forced-arbitration-restore [https://perma.cc/R6Z9-WXRM]; *see also* Okezie Chukwumerije, *The Evolution and Decline of the Effective-Vindication Doctrine in U.S. Arbitration Law*, 14 PEPP. DISP. RESOL. L.J. 375, 457–63 (2014).

[70] *See* Silver-Greenberg & Gebeloff, *supra* note 2.

[71] Deepak Gupta & Lina Khan, Policy Essay, *Arbitration as Wealth Transfer*, 35 YALE L. & POL'Y REV. 499, 503 (2017).

[72] *See* Alex Tallchief Skibine, *The Indian Gaming Regulatory Act at 25: Successes, Shortcomings, and Dilemmas*, 60 FED. LAW. 35, 40 (2013) ("If tribal immunity is perceived as being abused in order to victimize non-Indians otherwise protected under state law, such immunity will be severely tested and will be in danger of being lost."); Katherine Florey, *Making It Work: Tribal Innovation, State Reaction, and the Future of Tribes as Regulatory Laboratories*, 92 WASH. L. REV. 713, 757 (2017) ("[S]ome tribes have defended payday [lending] as the provision of a needed service to underbanked consumers and a reasonable expression of tribal sovereignty that is no different in kind from the 'sort of economic engineering' engaged in states like Delaware and South Dakota, 'which routinely export their corporate-favorable state laws' to consumers in more restrictive jurisdictions." (quoting Jennifer H. Weddle, *Nothing Nefarious: The Federal Legal and Historical Predicate for Tribal Sovereign Lending*, 61 FED. LAW. 58, 62 (2014))).