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Government Takes on Mandatory Arbitration Clauses in CFPB Proposed Rule

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If you have ever signed up for a credit card or checking account, then you are probably familiar with the lengthy, complicated contracts that typically accompany such consumer financial products. Because these contracts are standard, most consumers assume that they operate like basic contracts, and that in the event of a breach by the credit card company or bank, the consumer will have the right to remedy the breach in court.

While court action is an option in some circumstances, what consumers may not know is that many of these contracts contain mandatory arbitration clauses that effectively require the consumer to sign away his or her right to take the company to court if things go wrong.

Who Benefits from Mandatory Arbitration Clauses?

Mandatory arbitration clauses such as those found in consumer financial products and services contracts are not uncommon. Since 1925, with the enactment of the Federal Arbitration Act, arbitration has been a common feature of dispute resolution in the business world, and mandatory arbitration clauses have become a common feature of many business contracts. But despite the benefits arbitration provides to disputes between two corporate parties, there are drawbacks to the arbitration process that make it less appealing for parties other than businesses, such as consumers and employees.

This month, the federal agency charged with upholding consumers' rights, the U.S. Consumer Financial Protection Bureau (CFPB), took concrete action to address certain obstacles to consumers posed by mandatory arbitration clauses included in financial products and services contracts. Specifically, on May 5, the CFPB proposed a rule prohibiting fine print clauses that allow financial products and services companies to include mandatory arbitration clauses with class action bans in financial products and services contracts. Though the rule is still in its nascent stages, if adopted, it would pave the way for consumers to be able to take action together in a class action suit to remedy abuses by providers of consumer financial products and services. Such a rule could be a start to dismantling the stranglehold that mandatory arbitration has placed on access to the courts for consumers and potentially impact policy on similar provisions in other fields, including in the employment context.

Who Does the CFPB Rule Seek to Protect?

The CFPB's proposed rule is intended to protect consumers of financial products and services. Consumer financial products and services are an integral part of most of our daily lives. They include our credit cards, checking accounts, student loans, mortgages and mobile wireless services, to name a few. With few exceptions, these products and services are provided to consumers by consumer financial products and services companies, subject to the terms of a written contract.

While the terms of consumer financial products and services contracts are generally fairly standard, most consumers are unaware that their contracts often contain a provision requiring them to resolve disputes arising from the contract via arbitration, instead of in court. As originally conceived, arbitration was intended to be an informal, expedited process for resolving routine disputes between businesses outside of court. Today, although arbitration continues to provide many corporate parties with a cost-effective and efficient method of conflict resolution, there are drawbacks to the arbitration process that make it less appealing for certain parties, such as consumers. These drawbacks include high arbitration expenses, limited discovery, inconvenient venues, no public record, limited judicial review, limited remedies, and prohibition of class actions. A recent study also showed that employment disputes settled via arbitration tend to result in an increased "win rates" for the employer and lower payouts for those employees who did prove successful.

What Does the CFPB Rule Prohibit and Why?

The type of mandatory arbitration clauses that the CFPB's proposed rule targets are those that include provisions banning class action suits.

Consumer disputes typically involve individual complaints over small amounts. While these disputes may seem trivial on an individual scale, many consumer complaints can, when viewed in the aggregate, provide evidence of wide-scale wrongdoing by consumer financial products and services companies. Because individuals who seek to remedy this sort of wide-scale misconduct normally do not have the time or resources to recognize, investigate, or prove the existence of such fraudulent practices on their own, effectively remedying these scams often requires group action. However, according to the CFPB, many consumers are prevented from challenging wide-scale scams by consumer financial products and services companies because of the pervasiveness of mandatory arbitration clauses that contain class action bans in consumer financial products and services contracts.

In 2015, the CFPB published an empirical study on the incidence and impact of mandatory arbitration provisions in the consumer financial products and services industry. According to its report, the vast majority of contracts the CFPB studied included mandatory arbitration provisions that required arbitration for individual claims and prohibited arbitration on a class basis. Together, the CFPB found that these two provisions effectively barred consumers from bringing group claims either in court or through arbitration, even though class actions provide a more effective means for consumers to challenge questionable practices by consumer financial products and services companies. With this information, the CFPB concluded that class action bans in mandatory arbitration clauses effectively immunized consumer financial products and services companies from being held accountable for wrongdoing.

To remedy this obstacle to consumers, on May 5, the CFPB proposed a rule that would prohibit forced arbitration clauses unless the contract permits class actions in court. Under the proposal, companies would still be permitted to include arbitration in their contracts, provided that the arbitration provisions do not ban consumers from being part of a class action in court. According to the CFPB, the proposed rule has several potential benefits, including ensuring consumers get their day in court, deterring wrongdoing, and increasing transparency.

Does the CFPB Rule Affect People Other than Consumers?

Though it is specifically designed to affect only consumer contracts, the general message inherent in the CFPB's proposed rule – namely, that mandatory arbitration provisions banning class actions stymie individual rights against corporate entities – could have implications in other fields, including in the employment context.

As with consumers, it is not uncommon for a corporation to include a mandatory arbitration provision in its contract with its employees. Oftentimes, these provisions take away employees' rights to sue for violations of many important employment law violations, including rights to minimum wages and overtime pay, rest breaks, and protections against discrimination, to name a few. Moreover, and similar to the consumer context, it is not unusual for mandatory arbitration provisions in employment agreements to ban employees from making class action claims against the employer in court or before an arbitrator, thereby preventing employees from joining together to challenge systemic corporate wrongdoing. While the CFPB rule will have no bearing on the enforceability of similar class action bans in mandatory arbitration clauses in employment agreements, if enacted, the CFPB's proposed rule will provide a helpful guidepost to those interested in enacting similar limits on mandatory arbitration clauses in the employment context.