NOTE

OVERCOMING THE ACHILLES’ HEEL OF CONSUMER PROTECTION: LIMITING MANDATORY ARBITRATION CLAUSES IN CONSUMER CONTRACTS

I. INTRODUCTION

Many lawsuits are “doomed” irrespective of their merits.¹ These lawsuits may neither contain frivolous claims nor lack vital evidence.² Instead, they are precluded from judicial remedy because they arise out of contracts containing arbitration clauses.³ Aware of it or not, most Americans are bound by “several, if not dozens, of forced arbitration clauses.”⁴

Forced arbitration clauses are prevalent in “hundreds of millions of consumer contracts”;⁵ yet, consumers are generally unaware of the presence of these clauses.⁶ Mandatory arbitration clauses are often

². Id. at 1219; Christopher R. Leslie, The Arbitration Bootstrap, 94 TEX. L. REV. 265, 270 (2015).
⁶. See Arbitration Clauses Harm Consumers, GOLDMAN SCARLATO PENNY P.C., http://www.lawgsp.com/arbitration-clauses-harm-consumers (last visited Nov. 15, 2017) reporting that a study conducted by the Consumer Financial Protection Bureau (“CFPB”) “found that more than 75% of the consumers surveyed did not realize that they signed agreements containing
hidden within the fine print of terms for leases, and insurance, credit card, employment, and nursing home agreements. By simply signing a contract containing an arbitration clause or “clicking ‘I agree’ on a website,” a consumer may be instantly bound to take any dispute arising from that contract to arbitration.

Arbitration is a contractual method of resolving disputes in which parties select an impartial person, called an arbitrator, to render a decision. The decision of the arbitrator(s) is referred to as an award. Provided that a valid arbitration agreement exists and the dispute in question falls within the scope of the arbitration agreement, parties may be required to arbitrate their claims.

Arbitration often leads to speedier resolution of disputes compared to typical court proceedings because arbitration requires fewer formalities and the decision makers are often selected based upon their technical expertise or knowledge. Moreover, the fast-paced process of arbitration may minimize costs of dispute resolution and hostility between families and businesses in conflict. In addition, arbitration may provide more privacy for parties than a public hearing since arbitration may be subject to non-disclosure agreements.
However, certain disadvantages of arbitration may follow from the less formal procedures. For example, the right to discovery or the right of appeal may be limited—or even completely restricted—depending on the exact terms of the contract. Moreover, claimants may be further disadvantaged if they are forced to relinquish their right to a trial by jury. Unlike juries who often sympathize with claimants or judges who rely upon law and rules of evidence to make decisions, arbitrators may issue awards based upon broad and nebulous principles of justice, equity, and compromise. Unless parties specify otherwise in the contract, arbitrators are generally not bound to follow legal precedent. Furthermore, arbitration may require more time and resources than anticipated since the proceedings may become very lengthy, depending on the complexity of issues at hand. In the context of arbitration between consumers and commercial parties, the commercial party usually has the upper hand. The commercial party typically selects

 SAMPLE ARBITRATION CLAUSES WITH COMMENTS, http://www.acc.com/_cs_upload/vl/membersonly/SampleFormPolicy/409703_1.pdf (last visited Nov. 15, 2017) (“A confidentiality agreement in the agreement to arbitrate will preserve confidentiality, a significant benefit of the arbitration process for those companies that prefer not to have their business disputes made public.”).

15. See John W. Cooley & Steven Lubet, NITA PRACTICAL GUIDE SERIES: ARBITRATION ADVOCACY 6-7 (2d ed. 2003).


18. Novick & Whitehill, supra note 9, at 2-3; Slaughter & Rahne, supra note 17.


20. Novick & Whitehill, supra note 9, at 1; see Daniel E. González et al., Controlling the Rising Costs of Arbitration, FINANCIER WORLDWIDE (Oct. 2014), https://www.financierworldwide.com/controlling-the-rising-costs-of-arbitration/#.WHp6qsg9Ps (showing that costs of arbitration may increase dramatically depending on the number of expert witnesses, expenses for travel and accommodation of witnesses, and other logistical costs necessary, “such as necessary translation services, interpreter services, court reporter services, videographer services, rental fees for hearing rooms, food and beverage consumed during the hearings, photocopying and courier services, among others”).

21. See Walker, supra note 5, at 8.
the arbitrator based upon the arbitrator’s previous and often favorable decisions.22

This Note begins by analyzing the historical background of arbitration, including why it exists and its purposes, as well as the current state of the law.23 It then examines the actions taken by the Consumer Financial Protection Bureau (“CFPB”) to monitor arbitration.24 Part III discusses the legal issues and public policy concerns created by the use of pre-dispute mandatory arbitration clauses.25 Part IV argues that pre-dispute mandatory arbitration clauses in consumer contracts should be prohibited as intended by the drafters of the Federal Arbitration Act (“FAA”), and as other countries have already done.26 Alternatively, Part IV proposes model legislation that would regulate the use of mandatory arbitration clauses.27

II. HISTORY OF ARBITRATION IN AMERICA

It is well settled that “[t]he United States inherited arbitration from England.”28 This Part discusses the origins of arbitration in England, its transition into the American judiciary, and the current state of arbitration in the United States.29 This Part also discusses the development of the CFPB and the Bureau’s current state.30

22. See David Lazarus, Forced Arbitrations Fail to Resolve Disputes Fairly, L.A. TIMES, Mar. 23, 2015, at C1 (“A 2007 report by Public Citizen found that over a four-year period, arbitrators ruled in favor of banks and credit card companies 94% of the time in disputes with California consumers.”); Liz Kramer, Beyond the Headlines Part II: What the New CFPB Report Teaches Us About Arbitration v. Litigation, ARB. NATION (Mar. 12, 2015), http://arbitrationnation.com/beyond-the-headlines-part-ii-what-the-new-cfpb-report-teaches-us-about-arbitration-v-litigation (stating that the CFPB’s March 2015 study found that the arbitrators favored the consumer in only twenty percent of disputes and that consumers were only awarded an average of fifty-seven cents for every dollar claimed). Businesses may typically select an arbitrator based upon the arbitrators’ skills, expertise, and previous decisions. See NOVICK & WHITEHILL, supra note 9, at 2; Walker, supra note 5, at 8.

23. See infra Part II.A–B.

24. See infra Part II.C.

25. See infra Part III.

26. See infra Part IV.A.

27. See infra Part IV.B.


29. See infra Part II.A–B.

30. See infra Part II.C.
A. Development of Arbitration in England

Before the codification of laws or establishment of courts, English merchants resorted to arbitration in order to resolve disputes. However, even after the establishment of the Royal Courts, merchants continued to resort to outside adjudication that better served their needs. As early as the medieval period, trading communities relied on special tribunals to resolve disputes arising from local and international trade. To ensure the ability to arbitrate, commercial parties drafted their charters in order to permit dispute resolution in these special tribunals. As their purpose was to expedite the resolution of disputes, these tribunals were the predecessors of modern arbitral tribunals.

Despite widespread use of arbitration tribunals, courts remained hostile to arbitration and did not readily enforce arbitration awards. However, arbitration remained prevalent because arbitrators could potentially resolve disputes more quickly than judges due to their


32. 14 WILLIAM HOLDSWORTH, A HISTORY OF ENGLISH LAW 187 (A.L. Goodhart & H.G. Hanbury eds., 1964); William Catron Jones, History of Commercial Arbitration in England and the United States: A Summary View, in INTERNATIONAL TRADE ARBITRATION: A ROAD TO WORLD-WIDE COOPERATION 129-30 (Martin Domke ed., 1958). The Royal Courts were not adapted to serve the needs of merchants since the Royal Courts lacked the necessary expediency for transient merchants and were more concerned with the disputes over land and conduct that were detrimental to the King’s peace. Sarah Rudolph Cole, Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees, 64 UMKC L. REV. 449, 459-60 (1996); see JOHN F. PHILLIPS, ARBITRATION, LAW PRACTICE AND PRECEDENTS 9-10 (1988).


34. Id. at 12.

35. Id.

36. Larry J. Pittman, The Federal Arbitration Act: The Supreme Court’s Erroneous Statutory Interpretation, Stare Decisis, and a Proposal for Change, 53 ALA. L. REV. 789, 793-94 (2002). Arbitration awards were generally unenforceable because Royal Courts desired to maintain authority over legal disputes. Id. Slowly, the Royal Courts began to offer more protection for arbitration agreements and awards. See HOLDSWORTH, supra note 32, at 196-97. For instance, in 1746, an arbitration clause was struck down by the Royal Court because the enforcement would “oust courts of their jurisdiction.” Bruce L. Benson, An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States, 11 J.L. ECON. & ORG. 479, 483 (1995) (quoting Kill v. Hollister, 1 Wils. 129 (1746)). However, concerns over jurisdiction were likely motivated by financial concerns because Kings generated revenue from the intervening judicial activity. Id.
expertise in commercial and technical matters. Since traditional arbitration could be revoked any time before the award was determined, parties would often revoke the arbitrator’s authority when an unfavorable decision was suspected. In response to this abuse, England was compelled to enact the Arbitration Act of 1889 in order to make arbitration agreements irrevocable except by leave of the court; consequently, the framework for modern arbitration in the United States was established.

B. Rise of Commercial Arbitration in the United States

Arbitration in the United States traces back to the early colonial period. It was commonly used to resolve disputes between merchants and businessmen of different colonies because arbitration was more efficient and effective than courts during this time period. However, the ability of arbitrators to produce fair results was questioned in the late-nineteenth and early-twentieth centuries.

The rise of commercial arbitration grew out of the enthusiasm for a free market during the Roaring Twenties. Following the end of World War I, the economy in the United States was transformed by the shift from wartime to peacetime production. Consumerism dominated the 1920s as technology advanced in areas such as automobiles, household appliances, and other mass-produced products. The extraordinary destruction of World War I along with the consumerism of the 1920s facilitated the development of modern arbitration laws in America. Arbitration laws “reflected a societal desire to avoid future mass destruction and the belief that peaceful resolution of economic rivalries

37. NOUSSIA, supra note 33, at 12.
39. See id. at 246.
40. See BALES, supra note 28, at 5; Benson, supra note 36, at 481-83.
41. Benson, supra note 36, at 481-83.
42. See Jones, supra note 38, at 245-46.
44. The rise of mass production along with expansion of the consumer goods markets led to the economic expansion of the Roaring Twenties. THOMAS STREIGSGUTH, THE ROARING TWENTIES 276 (rev. ed. 2007).
could assist to avoid future wars.”

Prior to 1920, arbitration agreements were very difficult to enforce in New York. However, 1920 marked the year that New York adopted its first arbitration law, “revers[ing] the common-law rule of revocability of arbitration agreements.” The drafters of the New York law used its success to lobby Congress for a federal law that would similarly make arbitration agreements between merchants enforceable in federal court. The underlying purpose behind the federal law was to ensure that New Yorkers could compel out-of-statess to arbitrate claims. However, a federal law would have other purposes including the following: (1) to reduce consumer costs; (2) to reduce court delays; (3) to save time and

47. Imre Stephen Szalai, Exploring the Federal Arbitration Act Through the Lens of History, 2016 J. Disp. Resol. 115, 137-38. Many intellectuals and artists were shocked by the intolerance that many Americans expressed towards political radicals and immigrants following World War I. See 2 John M. Murrin et al., Liberty, Equality, Power ENHANCED CONCISE EDITION 678 (6th ed. 2014). Disillusioned by the popularity of conformity after World War I, a group of American intellectuals and artists—collectively known as the “Lost Generation”—gathered in Paris in order to transform their disillusionment into “rich literary sensibility.” Id. at 668-69.


51. 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, 101-02 (2006). One scholar has explained the magnitude of the New York statute as follows:

[O]ne cannot overstate the significance of the single salutary reform which made possible the extension of arbitration beyond the trade associations which were its main breeding ground and led to its wholesale employment in standardized agreements of all kinds. This, in turn, raised a whole host of new questions regarding public policy limitations and one-sidedness which were not a problem when arbitration was about two textile merchants arguing over the quality of the merchandise ...
money for the disputants; (4) to preserve business relationships; and (5) to simply enforce voluntary agreements to arbitrate disputes.\(^{53}\)

Pursuant to its commerce power, Congress passed the FAA in 1925.\(^{54}\) At the time the Act was passed, arbitration was typically between merchants and other commercial parties making consensual contracts, such as “contracts of insurance, ship charters, commercial leases, partnership agreements, goods contracts, [and] construction contracts.”\(^{55}\) However, many groups, especially labor unions, feared that the FAA would encourage the expansion of arbitration into areas that were not typically arbitrated.\(^{56}\)

For instance, labor unions feared that the Act “might authorize federal judicial enforcement of arbitration clauses in employment contracts and collective-bargaining agreements.”\(^{57}\) To quash these concerns, former Secretary of Commerce Herbert Hoover emphasized that the Act would not be applicable to contracts for labor and Hoover’s language was codified at 9 U.S.C. § 1.\(^{58}\) In hindsight, the fear of labor

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53. MACNEIL, supra note 51, at 29-30.
58. Id. at 127. Herbert Hoover suggested the following: If objection appears to the inclusion of workers’ contracts in the law’s scheme, [the FAA] might be well amended by stating “but nothing herein contained shall apply to contracts of employment of seamen, railroad employees or any other class of workers engaged in interstate or foreign commerce.”

Id. (Stevens, J., dissenting) (quoting Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong. 21 (1924)); see 9 U.S.C. § 1 (stating that the FAA “shall [not] apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce”). Hoover, one of the main proponents of the FAA, believed that it would help promote self-regulation of commercial parties. Carmen Comsti, A Metamorphosis: How Forced Arbitration Arrived in the Workplace, 35 BERKLEY J. EMP. LAB. L. 5, 11 (2014).
unions was not unreasonable because the courts have vastly expanded the scope of the FAA beyond that which Congress intended.\(^{59}\)

The FAA, originally intended as a procedural statute for agreements between commercial parties, was transformed into a substantive statute, applicable to both federal and state courts and consumer and employment contracts.\(^{60}\) As the Supreme Court expanded the scope of the FAA, lower courts were required to grant greater deference to arbitration agreements.\(^{61}\) Consequently, regardless of whether “the parties drafting these agreements increasingly included unfair and overreaching terms,” forced arbitration clauses were enforceable and consumers could only seek relief from unfair agreements through the unconscionability doctrine or through Congress.\(^{62}\)

C. Development of the Consumer Financial Protection Bureau

In 2008, a financial crisis of great magnitude left millions of Americans unemployed and resulted in devastation of private and public wealth.\(^{63}\) The “predatory subprime lending” scheme led by financial institution managers contributed to this economic recession, which harmed shareholders and consumers.\(^{64}\) The harm to consumers has been more long-lasting than to shareholders.\(^{65}\)

\(^{59}\) See infra Part III.

\(^{60}\) Thomas V. Burch, Regulating Mandatory Arbitration, 2011 Utah L. Rev. 1309, 1319-21. The FAA was part of a larger regulatory movement towards procedural simplification in federal courts. Szalai, supra note 47, at 119.

\(^{61}\) Burch, supra note 60, at 1325.

\(^{62}\) Id. After Doctor’s Associates v. Casarotto, state legislators were increasingly limited in their ability to regulate arbitration agreements. See 517 U.S. 681, 687 (1996) (holding that state law could not invalidate arbitration agreements).


\(^{64}\) Cheryl L. Wade, Fiduciary Duty and the Public Interest, 91 B.U. L. Rev. 1191, 1196-97, 1202-03 (2011); Wall Street Reform: The Dodd-Frank Act, supra note 63. The U.S. Senate Permanent Subcommittee on Investigations reported that the causes of the 2008 financial crisis included, but were not limited to, “high-risk mortgage lending, inflated credit ratings, structured products sold by investment banks, and repeated failures of regulatory agencies to provide adequate oversight of the financial services industry.” FEDERAL REGULATORY DIRECTORY 387 (17th ed. 2016).

\(^{65}\) Wade, supra note 64, at 1191-92. Consumers that do not have a diverse investment portfolio but are bound to one investment—their home—are typically more vulnerable to economic harm. Id. at 1192 n.2. According to Elizabeth Warren, Special Advisor to the Secretary of the
In response to the financial crisis of 2008, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The Dodd-Frank Act was an attempt to correct the shortcomings of the regulatory system that was in place at the time by regulating certain aspects of the financial services industry that were previously under-regulated or not regulated at all. The purpose of the Dodd-Frank Act was to increase transparency in consumer markets of financial services by requiring additional disclosures. The Dodd-Frank Act created a number of government agencies responsible for overseeing various components of the act, including the CFPB.


67. Dodd-Frank Wall Street Reform and Consumer Protection Act, supra note 66. Before the creation of the CFPB, “seven different Federal agencies were responsible for various aspects of consumer financial protection.” Megan Slack, Consumer Financial Protection Bureau 101: Why We Need a Consumer Watchdog, WHITE HOUSE (Jan. 4, 2012, 11:13 AM), https://www.whitehouse.gov/blog/2012/01/04/consumer-financial-protection-bureau-101-why-we-need-consumer-watchdog. It can be argued that the economic crisis of 2008 was inevitable since no single agency had the ability to effectively enact rules or monitor the market. See CONSUMER FED’N OF AM., ACCOUNTABILITY OF THE CONSUMER FINANCIAL PROTECTION BUREAU 1 (2011), http://www.consumerfed.org/pdfs/CFPB-Accountability-fact-sheet-6-11.pdf (“Massive regulatory failures by these agencies led to the proliferation of unfair and unsustainable lending practices, which deeply damaged millions of Americans and the overall economy.”).


1. Leadership Structure and Budget of the Consumer Financial Protection Bureau

The CFPB was established as an independent bureau within the Federal Reserve.70 Even as a subsidiary, the CFPB exercises “complete regulatory independence from the Board of Governors of the Federal Reserve.”71 To promote independence of the agency, Congress allocated an established percentage of funding from the budget of the Federal Reserve for the CFPB.72 Additionally, a minor portion of the Bureau’s funding originates from “receipts collected from interest on Treasury securities and filing fees pursuant to the Interstate Land Sales Full Disclosure Act of 1968.”73

The CFPB’s independent funding and leadership structure were designed in order to protect it from “agency capture.”74 Under the Dodd-
Frank Act, the CFPB was to be led by a single director—only removable by the President for cause—with a maximum term of five years. A single leader ostensibly permits more efficient execution of decisions than a board composed of several commissioners and therefore, better promotes consumers’ interests. Recently, however, a federal court of appeals has struck down the “for cause” provision and effectively permits the director to be removed by the President at will.


76. See Jennifer Liberto, Consumer Bureau 'Stalinistic' - Republican Senator, CNN MONEY (Dec. 12, 2011, 10:33 AM), http://money.cnn.com/2011/12/12/news/economy/consumer bureau_stalin. Traditionally government agencies run by a single leader are removable by the president at will. Peralta, supra note 75. Diversity in leadership of the CFPB may be critical since “[t]here is no single point of view that dominates this group, other than a shared vision to make consumer financial markets work better for all Americans.” See Warren, supra note 65.

77. Peralta, supra note 75. The author of this Note recognizes that the U.S. Court of Appeals for the District of Columbia has recently deemed the existing structure of the CFPB—a single director loosely accountable to the Executive and only removable for good cause—to be unconstitutional. PHH Corp. v. Consumer Fin. Prot. Bureau, 839 F.3d 1 (D.C. Cir. 2016), vacated, No. 15-1177, at 1 (D.C. Cir. Feb. 16, 2017). However, it should be noted that rather than eliminating the CFPB altogether, the Court of Appeals directed an amendment of the statute that created the agency. See PHH Corp., 839 F.3d at. 8-9. The amendment would provide the Executive the ability to remove the director of the CFPB at will, “as well as exert direct supervision and direction over a watchdog that has had unprecedented authority over home finance, student loans, credit cards and banking practices.” Kevin McCoy, Consumer Financial Protection Bureau Structure Ruled Unconstitutional, USA TODAY (Oct. 11, 2016, 3:58 PM), http://www.usatoday.com/story/money/2016/10/11/consumer-agency-structure-ruledunconstitutional/91902146/; see PHH Corp., 839 F.3d at. 8 (“With the for-cause provision severed, the President now will have the power to remove the Director at will, and to supervise and direct the Director. The CFPB therefore will continue to operate and to perform its many duties . . . ”). On February 6, 2017, the ruling was vacated and the D.C. Circuit Court of Appeals was scheduled to rehear the case on May 24, 2017. Alan Kaplinksy & Michael Guerrero, The CFPB Is Under Siege By All Three Branches of the Government, Hill (Feb. 17, 2017, 4:00 PM), http://thehill.com/blogs/pundits-blog/finance/320141-the-cfpb-is-under-siege-by-all-three-branches-of-government; see PHH Corp., No. 15-1177, at 1. A recently proposed Senate bill seeks to replace the single director with a five-member “Board of Directors.” S. 105, 115th Cong. § 2 (2017). Banking associations have also advocated for the leadership structure of the CFPB to be changed into a multi-member committee. See 5-Person CFPB Board Would Provide Continuity: CUNA to Congress, CREDIT UNION NAT’L ASS’N (Nov. 23, 2015), http://news.cuna.org/articles/108538-cuna-to-congress-5-person-cfpb-board-would-provide-continuity (stating that the Credit Union National Association and its partners have proposed that the CFPB operate as a five-member committee in order to function as a non-partisan consumer protection agency).
2. Current State of the Consumer Financial Protection Bureau

The CFPB began operating on July 21, 2011.78 The Bureau’s early work centered around “hiring within the complex federal process, securing physical facilities, acquiring technological systems, and writing office policies and procedures, as well as designing, drafting, and implementing federal regulations on investigative procedures and administrative adjudication.”79 However, the CFPB’s early enforcement operations were delayed by the Senate’s failure to confirm the Bureau’s first Director, Richard Cordray, for nearly two years.80

Under the Dodd-Frank Act, the CFPB was given jurisdiction to regulate the activities of consumer financial products or services through rulemaking, supervisory actions, and enforcement actions.81 The CFPB functions “[t]o protect consumers from unfair, deceptive, or abusive practices and take action against companies that break the law.”82

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[The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law . . . .

U.S. Const. art. II, § 2, cl. 2. Although she was the brainchild and forerunner to serve as the director of the CFPB, former President Obama did not nominate Elizabeth Warren to serve as the Bureau’s director. Todd Zywicki, The Consumer Financial Protection Bureau: Savior or Menace?, 81 Geo. Wash. L. Rev. 856, 862 (2013). The Obama Administration suspected that the Senate would not confirm the potential appointment of Warren due to strong Republican opposition to Warren’s political views. Id. Instead, former President Obama appointed Warren to serve as the Assistant to the President and Special Advisor to the Secretary of the Treasury on the CFPB in order to help design the Bureau. Elizabeth Warren Biography, BIOGRAPHY, http://www.biography.com/people/elizabeth-warren-20670753#political-career (last updated Feb. 8, 2017). In July 2013, Richard Cordray was appointed by former President Obama appointed and then confirmed by the Senate as director of the CFPB. Danielle Douglas, Senate Confirms Cordray to Head Consumer Financial Protection Bureau, Wash. Post (July 16, 2013), https://www.washingtonpost.com/business/economy/senate-confirms-consumer-watchdognominee-richard-cordray/2013/07/16/965882c2-ec2b-11e2-a1f9-ca873b7e0424_story.html.
Beginning in 2012, “the CFPB’s investigations and exams began to bear fruit in public law enforcement.”\(^{83}\) Between 2012 and 2015, the CFPB took the following actions:

[T]he Bureau announced 8 public enforcement actions. By the time the Senate confirmed Director Cordray on July 16, 2013, the Bureau had announced 17 public enforcement cases, including 6 against large banks and 11 against nonbank financial companies. In the calendar year 2013, the Bureau announced 27 actions. In 2014 and 2015, the Bureau announced 32 and 55 actions, respectively. Over the first 4 years of the Bureau’s active enforcement program, the number of public enforcement actions has roughly tracked the Bureau’s recruitment of staff.\(^{84}\)

In 2015, the CFPB continued to aggressively conduct enforcement actions and looked towards proposing rules.\(^{85}\) Before proposing a rule, the CFPB was required to conduct a study examining the prevalence and impact of arbitration clauses in consumer contracts.\(^{86}\) The study examined arbitration clauses in six different consumer finance markets: (1) credit cards, (2) checking accounts, (3) prepaid cards, (4) payday loans, (5) private student loans, and (6) mobile wireless contracts.\(^{87}\) The

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83. Peterson, supra note 78, at 1076. The CFPB may commence enforcement actions against an entity or a person provided that the Bureau believes that the entity or person has violated the law. Enforcement Actions, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/policy-compliance/enforcement/actions (last visited Nov. 15, 2017). The enforcement action may be commenced by filing an action in federal district court or by initiating an administrative adjudication proceeding. Id.; see Christopher J. Willis, CFPB’S ENFORCEMENT RULES: A “ROCKET Docket” that Looks Strangely Familiar, BALLARD SPAR LLC (Aug. 8, 2011), https://www.cfpbmonitor.com/2011/08/08/cfpbs-enforcement-rules-a-rocket-docket-that-looks-strangely-familiar (“In devising its rules for administrative enforcement proceedings, the CFPB seems to have taken the view that speed is the overriding goal.”). The administrative law judge (“ALJ”) conducts administrative proceedings in which the ALJ holds hearings and issues a recommended decision. 28 C.F.R. § 4.14 (2016); Enforcement Actions, supra.

84. Peterson, supra note 78, at 1076-77.


87. See generally id. The author of this Note acknowledges that the accuracy of the study conducted by the CFPB has been criticized. See Dani Kass, CFPB Accused of Withholding Public Arbitration Study Docs, LAW360 (Dec. 14, 2016, 5:00 PM), https://www.law360.com/articles/872293/cfpb-accused-of-withholding-public-arbitration-study-docs. For a further discussion on the shortcomings of the CFPB’s study, see The CFPB’S Flawed Arbitration “Study”, U.S. CHAMBER OF COM., (Mar. 8, 2016, 11:45 AM), https://www.uschamber.com/issue-brief/the-cfpb-s-flawed-arbitration-study.
study, publicly available as of March 2015, concluded that “[t]ens of millions of consumers use financial products or services that are subject to pre-dispute arbitration clauses.” For example, 99.9% of mobile wireless providers use arbitration clauses in consumer contracts.

In October 2015, the CFPB proceeded with its first potential rulemaking to limit arbitration agreements in certain consumer financial products and services. The proposed rule was finally published in the Federal Register on May 24, 2016. As proposed, the rule seeks to ban class action waivers in pre-dispute arbitration clauses and requires the submission of arbitral claims and awards to the CFPB. Consequently, arbitration clauses in consumer contracts would still be valid, but they must explicitly state that consumers are not prohibited from being part of a class action in court. Additionally, the enforceability of arbitration awards would be conditioned upon submission of specified arbitral records to the CFPB. During the ninety-day comment period, closing on August 22, 2016, the CFPB was flooded with over 120,000 comments in response to the proposed rule.

The final rule, including the aforementioned limitations and restrictions on pre-dispute arbitration clauses, was published in the Federal Register on July 19, 2017. However, President Trump recently repealed this rule such that it has “no force or effect.”

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88. CFPB Final Report, supra note 86, § 1.4.1.
89. Id. § 2.3 & tbl.1.
93. Id.
94. Id.
95. Id.
3. Shortcomings of the Consumer Financial Protection Bureau

The CFPB has limited resources for enforcement, and state attorneys general have done little to implement their new powers under the Dodd-Frank Act. Consequently, consumers are left with the burden of learning about their rights and having to actively pursue remedies. Consumers must contact and submit complaints to the Consumer Response Team of the CFPB. The complaints are then published by the CFPB on its “Consumer Complaint Database,” which “affords the public direct insight into the patterns of consumer problems around the country.” Finding violations of consumer financial law, the CFPB has proceeded to penalize financial institutions.

III. THE UNINTENDED EXPANSION OF ARBITRATION

Having discussed the development, current practice, and state of law of arbitration, this Part expands upon the shortcomings and public
policy concerns created by mandatory arbitration agreements.\textsuperscript{104} This Part also discusses the inherent unequal bargaining power between commercial parties and consumers, and explains how the lower standard of care that financial advisers owe to patrons already further disadvantages consumers.\textsuperscript{105} Lastly, this Part examines a recent example of preemption of state consumer protection law by federal law and the near dissolution of the unconscionability doctrine.\textsuperscript{106}

\textbf{A. Inherent Unequal Bargaining Power in Consumer Contracts}

Contracts of adhesion are apparent in nearly all consumer contracts.\textsuperscript{107} Consumer contracts are typically offered on a “take-it-or-leave-it” basis in which the consumer must either accept the terms of the contract or take her business elsewhere.\textsuperscript{108} However, even if the consumer were to seek services elsewhere, she would most likely face a similar dilemma.\textsuperscript{109} Consequently, consumer contracts are often contracts of adhesion in which the drafting party—almost always the commercial party—selects all the contract terms and therefore creates a power imbalance between the contracting parties.\textsuperscript{110}

Moreover, commercial parties typically hire sophisticated lawyers to draft the terms of the contract that are in the best interest of the commercial party.\textsuperscript{111} On the contrary, consumers do not typically consult lawyers before entering into contracts for everyday services, and as a result, equal access to information is seldom found in these contracting relationships.\textsuperscript{112} Information asymmetry exists when contracting parties do not have equal access to information.\textsuperscript{113} Information asymmetry frustrates the freedom of contract theory.\textsuperscript{114}

\begin{itemize}
\item \textsuperscript{104} See infra Part III.
\item \textsuperscript{105} See infra Part III.A–B.
\item \textsuperscript{106} See infra Part III.C.
\item \textsuperscript{107} Neal v. State Farm Ins. Cos., 10 Cal. Rptr. 781, 784 (Dist. Ct. App. 1961). An adhesion contract is defined as “a standard-form contract prepared by one party, to be signed by another party in a weaker position, usu. a consumer, who adheres to the contract with little choice about the terms.” Adhesion Contract, BLACK’S LAW DICTIONARY (10th ed. 2014).
\item \textsuperscript{109} Id. at 286.
\item \textsuperscript{111} See Sterkin, supra note 108, at 287.
\item \textsuperscript{112} See id.
\item \textsuperscript{113} Eric H. Franklin, Mandating Precontractual Disclosure, 67 U. MIAMI L. REV. 553, 561 (2013).
\item \textsuperscript{114} Id. at 563-64. Printing & Numerical Registering Co. v. Sampson describes the classic
In the context of mandatory arbitration clauses, the commercial party typically retains the ability to select the arbitrator or the arbitration institution and therefore, the “repeat player” phenomenon may have potentially deleterious effects on consumers. Unlike judges who receive a predetermined salary, arbitrators are generally only paid when they are selected to resolve a dispute. As a result, arbitrators may be incentivized to favor the commercial party—the repeat player—who may be likely select them to arbitrate claims again. Therefore, some scholars believe that arbitrators have biases favoring commercial parties since their livelihoods are dependent upon being selected to resolve future disputes. Since arbitration records are often subject to confidentiality, consumers may be unable to discover repeated bad conduct and hold arbitrators accountable.

B. Restrictions on Imposing Fiduciary Relationships

In the context of consumer contracts for financial services, customers must be wary since not until recently have all financial
advocates been required to act as fiduciaries.120 Fiduciaries must act in the best interest of the client, manage the client’s money and property carefully, keep the client’s money and property separate from her own, and to keep accounting records for the client.121 A fiduciary relationship may “arise[] when the parties are in certain special relationships such as a principal-agent, attorney-client, and guardian-ward” as well as “when a person entrusts another with money or property.”122 Courts may have discretion to impose an informal fiduciary relationship when parties have unequal bargaining power and the stronger party has an incentive to take advantage of the weaker party.123 However, absent proof that


121. CONSUMER FIN. PROT. BUREAU, MANAGING SOMEONE ELSE’S MONEY: HELP FOR AGENTS UNDER POWER OF ATTORNEY 6 (2015), http://files.consumerfinance.gov/f/201310_cfpb_lay_fiduciary_guides_agents.pdf. For the entire guidelines released by the CFPB that explain the responsibilities of a fiduciary, see id. The guidelines created by the CFPB were particularly targeted for financiers acting on behalf of older Americans since many older Americans are vulnerable to fraud and scam as they experience declining capacity to handle finances. CFPB Releases Guides for Managing Someone Else’s Money, CONSUMER FIN. PROTECTION BUREAU (Oct. 29, 2013), http://www.consumerfinance.gov/about-us/newsroom/cfpb-releases-guides-for-managing-someones-else-money.


123. Budnitz, supra note 122, at 300; see Hydro-Mill Co. v. Hayward, Tilton & Rolapp Ins. Assocs., 10 Cal. Rptr. 3d 582, 593 (Ct. App. 2004) (“The insurer-insured relationship . . . is not a true ‘fiduciary relationship’ in the same sense as the relationship between trustee and beneficiary, or attorney and client. . . . It is, rather, a relationship often characterized by unequal bargaining power . . . in which the insured must depend on the good faith and performance of the insurer . . . . This characteristic has led the courts to impose ‘special and heightened’ duties, but [w]hile these ‘special’ duties are akin to, and often resemble, duties which are also owed by fiduciaries, the fiduciary-like duties arise because of the unique nature of the insurance contract, not because the insurer is a fiduciary.”) (quoting Vu v. Prudential Prop. & Casualty Ins. Co., 33 P.3d 487, 492 (Cal. 2001)); Tran v. Farmers Grp. 128 Cal. Rptr. 2d 728, 735 (Ct. App. 2002) (citations omitted) (“The insurer-insured relationship is not a true fiduciary relationship . . . . It is, rather, a relationship often characterized by unequal bargaining power in which the insured must depend on the good faith and
both parties understood that the weaker party reposed trust or confidence in the stronger party, and both parties reasonably expected that the stronger party was to act on behalf of the weaker party, courts seldom impose fiduciary relationships.\textsuperscript{124}

Historically, many financial advisors were held to the suitability standard—a less stringent obligation than the fiduciary standard.\textsuperscript{125} Financial Industry Regulatory Authority (“FINRA”) rule 2111 requires that firms or associated people “have a reasonable basis to believe a recommended transaction or investment strategy involving a security or securities is suitable for the customer.”\textsuperscript{126} Rule 2111 lists three main suitability obligations for firms and associated persons: (1) reasonable-basis suitability,\textsuperscript{127} (2) customer-specific suitability,\textsuperscript{128} and (3) quantitative suitability.\textsuperscript{129}

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\textsuperscript{124} Budnitz, supra note 122, at 308-09. For example, a fiduciary relationship may be imposed between a lender and customer upon findings that the customer reposed trust in the lender. \textit{Id.} at 327. However, “if customers are required to show that they reposed trust and confidence in the bank, they will face substantial problems of proofs.” \textit{Id.}

\textsuperscript{125} See Kate Dore, \textit{What the New DOL Fiduciary Rule Means for You}, \textsc{Magnify Money} (June 9, 2017), http://www.magnifymoney.com/blog/consumer-watchdog/new-dol-fiduciary-rule-means; Blake Fambrough, \textit{Why Fees and the Fiduciary Standard Matter to Investors}, \textsc{Nerdwallet} (June 24, 2016), https://www.nerdwallet.com/blog/investing/fees-fiduciary-standard-matter-investors. Currently, most investment advisors are only held to the suitability standard, however, the Department of Labor has recently mandated that advisers to retirement assets hold themselves to the fiduciary standard. Employee Benefits Security Administration, 81 Fed. Reg. 20,946, 20,946 (Apr. 8, 2016) (to be codified at 29 C.F.R. pts. 2509, 2510, 2550).

\textsuperscript{126} See FINRA \textsection 2111 (FIN. INDUS. REGULATORY AUTH. 2014) (emphasis added); see also \textit{Suitability}, \textsc{FIN. INDUS. REG. AUTHORITY}, http://www.finra.org/industry/suitability (last visited Nov. 15, 2017). FINRA is “[a]n independent organization authorized by Congress to enforce the organization’s rules governing securities broker-dealers.” \textit{Financial Regulatory Authority, BLACK’S LAW DICTIONARY} (10th ed. 2014).

\textsuperscript{127} \textit{Suitability}, supra note 126. Reasonable-basis suitability requires that a broker must “have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors.” \textit{Id.}


\textsuperscript{129} \textit{Suitability}, supra note 126. \textsc{Bradley Berman, Frequently Asked Questions About FINRA Rule 2111 – SUITABILITY 2-3} (2016), https://media2.mofo.com/documents/faq-finra-rule-2111-suitability.pdf. Quantitative suitability requires that “[a] person who has actual or de facto control over a customer account to have a reasonable basis to believe that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer’s investment profile.” \textit{Id.}
The reasonable basis was based upon information obtained through the “reasonable diligence” of the firm or the associated person to understand the customer’s investment profile.130 The following information composes a customer’s investment profile: “age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information that the customer may disclose to the member or associated person in connection with such recommendation.”131 Asking a client for the aforementioned profile information usually suffices to satisfy the requisite due diligence.132 Unlike the fiduciary standard, the suitability standard did not require that financial advisors give advice in the best interest of the client.133 Consequently, the suitability standard allows for conflicts of interest.134

Conflicts of interest may arise when financial services professionals earn a commission on the product sold to a consumer.135 Financial advisors could recommend any action provided that the action meets the suitability standard—even if such is the least suitable action.136 As a result, the financial advisor could be motivated to sell the financial product or service generating the greatest revenue rather than the service or product that is best suited for the consumer.137 Consumers were

131. FINRA r. 2111(a).
132. Suitability: What Investors Need to Know, supra note 130. Reasonable diligence requires that “if the client exhibits signs of diminished capacity or other ‘red flags’ then the broker can have reasonable course to believe their information is inaccurate and should be cautious about recommending a transaction.” John Nedge, 3 Key Points to Understanding FINRA Rule 2111 on Suitability, POCKET RISK BLOG, http://blog.pocketrisk.com/3-key-points-to-understanding-finra-rule-2111-on-suitability (last visited Nov. 15, 2017).
137. Bromberg & Cackley, supra note 135, at 312. The author of this Note acknowledges that there are two predominant compensation structures for advisors: (1) a fee-based model and (2) a transaction-based model. BOB HERGET, FINANCIAL ADVISORS, HIDDEN FEES, INCENTIVES &
further disadvantaged since they usually must arbitrate any dispute arising from the transaction with the financial adviser.  

C. Limited Application of the Savings Clause of the Federal Arbitration Act

The Supreme Court has vastly limited the use of the “savings clause” to protect consumers against unfair arbitration agreements. The savings clause of the FAA provides limitations on the enforcement of arbitration agreements in contracts. The clause states that arbitration agreements are generally valid and enforceable “save upon such grounds as exist at law or in equity for the revocation of any contract.” The intended purpose of the FAA was “to place arbitration agreements on the same footing as other contracts.” However, “the United States Supreme Court has thwarted the equal footing policy established in the FAA and replaced it with a judicial policy favoring arbitration.”

1. Limitations on State Consumer Protection Law

Where state law prohibits arbitration based on grounds of public policy or reasonable expectations, federal law generally preempts state law. According to the Supremacy Clause, state courts are forbidden

STANDARDS: THE FORCES DRIVING INVESTMENT ADVICE 6-7 (2015), http://safeharborpartners.com/wp-content/uploads/SHP-Fee-Transparency.pdf. In the fee-based model, advisors “receive a percentage of total assets under management” and therefore, “[t]he better the accounts perform, the greater the compensation the advisor receives.” Id. at 6. On the contrary, in a transaction-based model, income is dependent upon commissions “directly tied to the market activity and market conditions.” THE INVESTMENT BANKING HANDBOOK 409 (J. Peter Williamson ed., 1988).


143. Id.

144. See, e.g., Kindred Nursing Ctrs. Ltd. P’ship v. Clark, No. 16-32, slip. op. at 9 (U.S. May 15, 2017) (“As we did just last Term, we once again ‘reach a conclusion that . . . falls well within the confines of (and goes no further than) present well-established law.’ The Kentucky Supreme Court specifically impeded the ability of attorneys-in-fact to enter into arbitration agreements. The court thus flouted the FAA’s command to place those agreements on an equal footing with all other contracts.” (quoting DIRECTV, Inc. v. Imburgia, 136 S. Ct. 463, 471 (2015))); Roberts, supra note
“to dissociate themselves from federal law because of disagreement with its content or a refusal to recognize the superior authority of its source.”\textsuperscript{145} Whether a particular federal law preempts an existing law is dependent upon the congressional intent of the federal law.\textsuperscript{146} Congress may express its purpose explicitly through the language of the legislation or impliedly through the structure and purpose of legislation.\textsuperscript{147} Under the Supremacy Clause, from which the preemption doctrine is derived, “any state law, however clearly within a State’s acknowledged power, which interferes with or is contrary to federal law, must yield.”\textsuperscript{148}

The preemption of state consumer protection law by federal judicial policy favoring arbitration is apparent in the Supreme Court’s decision in \textit{AT&T Mobility LLC v. Concepcion}.\textsuperscript{149} In \textit{Concepcion}, Vincent and Lisa Concepcion entered into an agreement for the sale and servicing of cellular telephones with AT&T Mobility LLC (“AT&T”).\textsuperscript{150} The contract provided for arbitration of all disputes between the parties and prohibited class action suits.\textsuperscript{151} The dispute arose from AT&T’s marketing of the cellphones as free of charge.\textsuperscript{152} Although the Concepcions did not pay the retail price for the cellphones, they were still charged sales tax ($30.22) based on the retail price of the phones.\textsuperscript{153} The Concepcions originally filed a complaint in a California federal district court claiming that AT&T “engaged in false advertising and fraud by charging sales tax on phones it advertised as free.”\textsuperscript{154} Pursuant to the arbitration clause in the agreement, AT&T moved to compel

\begin{itemize}
  \item \textsuperscript{139}, at 1558. Federal preemption is the principle in which “federal law can supersede or supplant any inconsistent state law or regulation.” \textit{Preemption}, BLA\textsc{k}’S LAW DICTIONARY (10th ed. 2014).
  \item \textsuperscript{145}. \textit{Imburgia}, 136 S. Ct. at 468 (quoting \textit{Howlet v. Rose}, 496 U.S. 356, 371 (1990)); see \textsc{U.S. Const. art. VI, cl. 2.}
  \item \textsuperscript{146}. Christopher R. Drahozal, \textit{Federal Arbitration Act Preemption}, 79 IND. L.J. 393, 397-98 (2004).
  \item \textsuperscript{147}. \textit{Cipollone v. Liggett Grp., Inc.}, 505 U.S. 504, 516 (1992).
  \item \textsuperscript{149}. \textit{See} 563 U.S. 333 (2011).
  \item \textsuperscript{150}. \textit{Id.} at 336.
  \item \textsuperscript{151}. \textit{Id.} at 336-37.
  \item \textsuperscript{152}. \textit{Id.} at 337.
  \item \textsuperscript{153}. \textit{Id.}
  \item \textsuperscript{154}. \textit{Id.}
\end{itemize}
arbitration, but the Concepcions “contend[ed] that the arbitration agreement was unconscionable and unlawfully exculpatory under California law because it disallowed class wide procedures.”155

Upon review of the case, the Supreme Court stated that the savings clause of the FAA “permits agreements to arbitrate to be invalidated by ‘generally applicable contract defenses, such as fraud, duress, or unconscionability,’ but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.”156 In Concepcion, the Court held that the savings clause did not intend “to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA’s objectives.”157 The Court warned consumers that the FAA “cannot be held to destroy itself.”158 Consequently, preemption of state consumer protection laws by the FAA has harmed states’ abilities to monitor abuses in consumer markets.159

2. Limitations of Application of the Unconscionability Doctrine

While the Supreme Court has sanctioned use of the unconscionability doctrine, Concepcion left little room for its actual

155. Id. at 337-38.
156. Id. at 339 (quoting Doctor’s Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996)).
157. Id. at 343.
158. Id. (quoting Am. Tel. & Tel. Co. v. Cent. Office Tel., Inc., 524 U.S. 214, 227-28, (1998)).
159. Preemption, NAT’L CONSUMER LAW CTR., http://www.nclc.org/issues/preemption.html (last visited Nov. 15, 2017); see, e.g., Marmet Health Care Ctr., Inc. v. Brown, 565 U.S. 530, 533 (2012) (per curiam) (“West Virginia’s prohibition against predispute agreements to arbitrate personal-injury or wrongful-death claims against nursing homes is a categorical rule prohibiting arbitration of a particular type of claim, and that rule is contrary to the terms and coverage of the FAA.”); Sanchez v. Valencia Holding Co., 355 P.3d 741, 757 (Cal. 2015) (“We conclude that the CLRA’s [Consumer Legal Remedies Act] anti-waiver provision is preempted insofar as it bars class waivers in arbitration agreements covered by the FAA.”); Estate of Ruszala v. Brookdale Living Cmtys., Inc., 1 A.3d 806, 818-19 (N.J. Super. Ct. App. Div. 2010) (“Our State’s prohibition of arbitration agreements in nursing home contracts, designed to protect the elderly, is thus irreconcilable with our national policy favoring arbitration as a forum for dispute resolution. Under our federal system of government, national policy prevails. Therefore, the FAA’s clear authorization nullifies the specific prohibition of arbitration provisions in nursing home or assisted living facilities’ contracts contained in N.J.S.A. 30:13-8.1.”); Schiffer v. Slomin’s, Inc., 11 N.Y.S.3d 799, 802 (App. Div. 2015) (“General Business Law § 399-c is a categorical rule prohibiting mandatory arbitration clauses in consumer contracts, and thus, at least where there exists a nexus with interstate commerce, is displaced by the FAA.”). Although the preemptive scope of the FAA is broad, states may enact consumer protection laws limiting arbitration under the following circumstances: “(1) where state arbitration laws act as a ‘gap-filler’ to the FAA; (2) where the FAA provides rules for federal courts without preempting different state court rules; and (3) where parties expressly contract for state law to apply.” Caroline Harris Crowne & Julia E. Markley, Federal Arbitration Act Preempts Oregon Legislature’s 2007 Amendment to Oregon Arbitration Act, LITIG., J., Summer 2008, at 4, 6 (2008), http://tonkon.com/assets/documents/news//Federal%20Arbitration%20Act%20Preempts%20Oregon%20Legislature’s%202007%20Amendment%20to%20Oregon%20Arbitration%20Act.pdf.
application. Traditionally, unconscionable agreements are those “such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.”

However, courts and academic institutions have developed different definitions of unconscionability. The Uniform Commercial Code ("U.C.C.") establishes a litmus test of determining unconscionability by looking to “[w]hether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.”

The U.C.C. treats unconscionable contracts and clauses as follows:

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

Typically, courts recognize two types of unconscionability: (1) procedural unconscionability and (2) substantive unconscionability. Procedural unconscionability refers to the circumstances in which the contract was formed, while substantive unconscionability refers to the literal terms of the contract.

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160. See supra Part III.C.1.
162. Susan Randall, Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability, 52 BUFF. L. REV. 185, 189-90 (2004). The Uniform Commercial Code “states simply that a court may refuse to enforce an unconscionable contract or clause, or may limit an unconscionable clause to avoid an unconscionable result.” Id. at 190 (citing U.C.C. § 2-302 (AM. LAW INST. & NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS)). Unconscionability has been criticized for its vagueness and uncertainty. See Amy J. Schmitz, Embracing Unconscionability’s Safety Net Function, 58 ALA. L. REV. 73, 84-85 (2006). Additionally, many law and economics supporters claim that unconscionability undermines economic efficiency because “individuals are perfectly rational and have all necessary information which they use to make contract choices and that enforcement of these rational choices will maximize overall societal wealth.” Id. at 75.
164. Id. § 2-302(1).
166. Craswell, supra note 165, at 1.
Before *Concepcion*, the defense of unconscionability was “firmly but uncomfortably” permitted as a defense against arbitration.\(^{168}\) The Supreme Court went so far as to say that “[s]tates may not . . . decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause.”\(^ {169}\) *Concepcion* further limited the ability of consumers to invoke unconscionability as a defense against enforcing arbitration clauses.\(^ {170}\) Although a generally applicable contract defense would otherwise be preserved by the savings clause, laws protecting against unconscionability are preempted when “applied in a fashion that disfavors arbitration.”\(^ {171}\) Moreover, *Concepcion* further muddied the waters regarding the application of the unconscionability doctrine because the Supreme Court was unclear about how the unconscionability doctrine could be reconciled with the FAA.\(^ {172}\)

IV. MANDATORY PRE-DISPUTE ARBITRATION SHOULD BE PROHIBITED OR RESTRICTED BY LEGISLATION

Due to the unequal bargaining power between parties, as well as the nearly unrestrained use of arbitration clauses in consumer contracts, the use of mandatory pre-dispute arbitration clauses in consumer contracts is contrary to public policy and thus should be prohibited or at the very least, restricted.\(^ {173}\) Mandatory pre-dispute arbitration clauses should be completely restricted through legislation prohibiting the use of these clauses in consumer contracts.\(^ {174}\) Alternatively, this Note also suggests that the use of mandatory pre-dispute arbitration clauses in consumer contracts should be limited through legislation, thereby, minimizing the impact of the public policy concerns previously discussed in this Note.\(^ {175}\)

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170. Wilson, *supra* note 142, at 118-19; *see* Perry v. Thomas, 482 U.S. 483, 492-93, 492 n.9 (1987) (“A court may not . . . rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.”).
173. *See supra* Part III.A.
174. *See infra* Part IV.A.
175. *See infra* Part IV.B.
A. The Scope of the Federal Arbitration Act
Should Be Limited in Order to Restrict the Use of
Mandatory Arbitration Clauses in Consumer Contracts

The Supreme Court has expanded the scope of the FAA beyond
that which its drafters intended and therefore, the scope of the FAA
should be limited in order to restrict the use of mandatory arbitration in
consumer contracts. Generally, the use of mandatory arbitration
clauses in consumer contracts is contrary to public policy because
consumer contracts are typically contracts of adhesion. The legislative
history of the FAA indicates that the violation of public policy falls
within the actual text of the savings clause of the FAA.

1. The Supreme Court Expanded the Scope of the Federal
Arbitration Act Beyond the Intentions of Its Drafters

The Supreme Court misinterpreted the intent of the drafters of the
FAA and consequently held mandatory arbitration clauses generally
“valid, irrevocable, and enforceable” in consumer contracts. Congress
passed the FAA was passed in order to enforce arbitration clauses in
federal courts—not state courts. Pursuant to a House Committee

176. See infra Part IV.A.1.
177. See supra Part III.A.
178. See infra Part IV.A.1. Although legislative intent is only persuasive legal authority, some
courts have relied upon legislative intent when “the legislative intent is so clear.” See State v. N.J.
argues that the phrasing of the language indicates a legislative intent to impose on the executive
branch the same one-pronged test that the Act applies to superintendents and assistant
superintendents within school districts. We do not agree that the legislative intent is so clear
Div. 1982), aff’d, 450 N.E.2d 213 (N.Y. 1993) (“Implied repeals are not favored by the courts, and
should be found only where the legislative intent is so clear, or two statutory provisions are so
mutually inconsistent, that the only possible conclusion is that an earlier enactment was in fact
repealed by a later enactment.” (emphasis added)); Oregon v. Galligan, 816 P.2d. 601, 604 (Or.
1991) (en banc) (“Because the legislative intent is so clear, and because the context of ORS 162.135
requires it, we hold that the word ‘custody,’ as used in ORS 162.135(7), includes detention in a
correctional facility.” (emphasis added)); see also Jesse M. Barrett, Note, Legislative History, the
Neutral, Dispassionate Judge, and Legislative Supremacy: Preserving the Latter Ideals Through the
Former Tool, 73 NOTRE DAME L. REV. 819, 826-27 (1998) (discussing that legislative intent may
be particularly useful in statutory construction when the “statutory language is insufficient to
eliminate all ambiguities”).
arbitration are willing to proceed under it, they need not resort to the courts at all.”); Horton, supra
note 1, at 1225-27; supra Part III.
simply that such agreements for arbitration shall be enforced, and provides a procedure in the
Federal courts for their enforcement.”).
Report on the FAA, the enforceability of arbitration agreements was a question of procedural law rather than substantive law.\textsuperscript{181} Consequently, as a question of procedural law, the enforceability of an arbitration provision would be determined based upon the reviewing court rather than the forum in which the contract was made.\textsuperscript{182} As a result, the enactment of the federal law was crucial to the ability to enforce arbitration clauses in contracts between parties located in different states.\textsuperscript{183}

The strictly procedural nature of the FAA was also confirmed by the simultaneous support of FAA advocates and reformers to the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in support of an arbitration act.\textsuperscript{184} If enacted, the NCCUSL’s proposed arbitration act would have enabled states to create laws that would make pre-dispute arbitration agreements enforceable in state courts.\textsuperscript{185} Consequently, if the FAA was intended to be applicable in state courts, the NCCUSL’s proposal would have been not only unnecessary but also redundant.\textsuperscript{186}

Moreover, comments by legislators and reform advocates during the time period have demonstrated that the FAA was never intended to be applied to consumer or employment contracts.\textsuperscript{187} Instead, Congress intended that application of the FAA would be limited to agreements between businesses with relatively equal bargaining power.\textsuperscript{188} For

\textsuperscript{181} Horton, supra note 1, at 1226-27; see H.R. REP. NO. 68-96, at 2.

\textsuperscript{182} See H.R. REP. NO. 68-96, at 1 ("Before [arbitration] contracts could be enforced in the Federal courts, therefore, this law is essential. The bill declares that such agreements shall be recognized and enforced by the courts of the United States."); Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong. 37 (1924) ("A Federal statute providing for the enforcement of arbitration agreement does relate solely to procedure of the Federal courts.").

\textsuperscript{183} Burch, supra note 60, at 1313-15.

\textsuperscript{184} Id. at 1316-17.

\textsuperscript{185} Id. at 1317.

\textsuperscript{186} Id.; Sternlight, Panacea or Corporate Tool?, supra note 3, at 649-50 ("The fact that the same groups that sought passage of the FAA were working simultaneously on state laws that would have been superfluous if the FAA were truly intended to govern the state forum as well as the federal bolsters this conclusion."). The idea that the FAA was originally intended to only apply to federal courts is confirmed by the repeated references to "federal courts" in the Act. See MACNEIL, supra note 51, at 106-07 ("Either the A.B.A. and Congress were being extraordinarily dense in failing to recognize that those references should be to all courts, or they meant exactly what they said when they referred only to federal courts.").

\textsuperscript{187} See Moses, supra note 51, at 99-100 (footnotes omitted) ("Today’s statute [(FAA)]—which has been construed to preempt state law, eliminate the requirement of consent to arbitration, permit arbitration of statutory rights, and remove the jury trial right from citizens without their knowledge or consent . . . ").

\textsuperscript{188} See id. at 106.
instance, Charles Bernheimer, Chairman of the Arbitration Committee of the New York Chamber of Commerce, stated that the FAA was meant to apply only to voluntary agreements with the purpose of “preserv[ing] business friendships.”

However, in 1984, the Supreme Court transformed the FAA into a substantive federal law that would trump conflicting state laws in state court. In Southland Corp. v. Keating, the Supreme Court divorced the FAA from its legislative history—an act of judicial activism—and rewrote the Act into a meaning of its choosing. The Court justified expanding the scope of the FAA by relying upon the national policy of favoring arbitration in order do the following: “(1) cover statutory disputes and employment agreements, (2) preempt state consumer-protection laws, and (3) eliminate arbitration’s consent requirement.” Following the decision, “companies increasingly began adding arbitration provisions to their consumer, employee, and franchisee agreements—often using those provisions to restrict or eliminate the nondrafting parties’ rights.” Despite the lack of legislative consent, the Supreme Court instructed the lower courts to enforce arbitration clauses “since parties should have autonomy to negotiate the manner in which they resolve disputes.”

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190. See infra notes 191-201 and accompanying text.


192. See id. at 11-12 (“The Arbitration Act was an exercise of the Commerce Clause power [that] clearly implied the substantive rules of the Act were to apply in state as well as federal courts. . . . [W]hen Congress exercises its authority to enact substantive federal law under the Commerce Clause, it normally creates rules that are enforceable in state as well as federal courts.” (citing Prima Paint Corp. v. Flood & Conklin Mfg., Co. 388 U.S. 395, 420 (1967) (Black, J., dissenting))); Moses, supra note 51, at 130-31.

193. Burch, supra note 60, at 1322.

194. Id. at 1309; see id. at 1325.

195. Id. at 1309 (emphasis added). The author of this Note acknowledges that many businesses operating at arms-length may bilaterally consent to arbitration in order “to keep the transaction, which is often part of a continuing relationship, running smoothly.” See Dale Beck Furnish, Commercial Arbitration Agreements and the Uniform Commercial Code, 67 CALIF. L. REV. 317, 318 (1979). However, there is an inherent unequal bargaining power between consumers and commercial parties and therefore, contract law should reflect this phenomenon. See supra Part III.A.
The Supreme Court further misinterpreted the FAA in *AT&T Mobility LLC v. Concepcion* when it discounted the savings clause.\(^{196}\) When completing its preemption analysis, the Court did not properly consider the meaning of the savings clause within the framework of the FAA’s statutory purpose.\(^{197}\) The Court found that the savings clause could not be invoked to save a right that “would be absolutely inconsistent with the provisions of the act.”\(^{198}\) Although Congress made no explicit statement regarding the purposes of the Act within the actual text of the FAA, the public policy exception is clearly within the plain text of the savings clause.\(^{199}\) However, the Supreme Court refused to invoke the savings clause to render an arbitration clause unenforceable since “doing so would conflict with that statutory purpose.”\(^{200}\)

Accordingly, the Court “[i]n effect wrote the savings clause out of the FAA for purposes of its preemption analysis.”\(^{201}\)

2. Functionality of Restricting Mandatory Arbitration in Consumer Contracts

The United States already restricted mandatory arbitration clauses in closed consumer credit transactions and should extend this policy to mandatory arbitration clauses to all consumer contracts.\(^{202}\) For instance, “[a] contract or other agreement for a consumer credit transaction secured by a dwelling” may not be subject to pre-mandatory arbitration clauses.\(^{203}\) However, consumers and lenders still remain eligible to settle or arbitrate any dispute after the dispute arises.\(^{204}\)

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196. See 563 U.S. 333, 344 (2011). For a further discussion on preemption and *Concepcion*, see supra Part III.C.

197. *Concepcion*, 563 U.S. at 343-45 (stating that the “principal purpose” of the FAA—readily apparent from the text—was to “ensur[e] that private arbitration agreements are enforced according to their terms” (quoting Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989))).

198. *Id.* (quoting Am. Tel. & Tel. Co. v. Cent. Office Tel., Inc., 524 U.S. 214, 227-28 (1998)).


201. *Id.*


Moreover, other nations have demonstrated that the restriction of mandatory arbitration clauses in consumer contracts proves to be a workable model. For example, France restricted the use of mandatory pre-dispute arbitration clauses in contracts between consumers and businesses. The French Civil Code permits the submission of disputes to arbitration in most commercial transactions but implicitly bars enforcement of pre-dispute arbitration clauses in consumer contracts. Moreover, the French Civil Code considers arbitration clauses between businesses and consumers to be “unfair” and detrimental to consumers due to the “significant imbalance between the rights and obligations of the parties to the contract.” Because of the inherent imbalance of power between commercial parties and consumers, the FAA should be interpreted by courts to exclude consumer contracts or Congress should amend the FAA as to expressly exclude consumer contracts. Accordingly, states would be able to protect their residents.

205. See FRANZ T. SCHWARTZ & CHRISTIAN W. KONRAD, THE VIENNA RULES: A COMMENTARY ON INTERNATIONAL ARBITRATION IN AUSTRIA 15-16 (2009) (“Indeed, under Section 617(5) ZPO, the arbitration agreements ‘shall be of relevance only if the consumer invokes it’, if consumer, at the time the arbitration is concluded or when the arbitration is initiated, does not have his domicile, habitual place of residence or place of employment in the jurisdiction where the arbitration has its seat. . . . [T]he new arbitration law makes it practically impossible to conclude an arbitration agreement with a consumer.” (citing ZIVILPROZESSORDNUNG [ZPO] [CIVIL PROCEDURE STATUTE] § 617 (5), https://www.ris.bka.gv.at/Dokument.wxe?Abfrage=Bundesnormen&Dokumentnummer=NOR40072303 (Austria))); Wolf Theiss & Katerina Kulhankova, Twilight of Arbitration Classes in Czech Consumer Credit Agreements, LEXOLOGY (Dec. 19, 2016), http://www.lexology.com/library/detail.aspx?g=635930d0-3249-472b-9249-c04339a207ef (explaining that amendments to the Consumer Credit Act in the Czech Republic completely bar arbitration as a mechanism of dispute resolution between credit providers and consumers, and all consumer credit disputes must be resolved by regular courts as a result); World Heritage Encyclopedia, Arbitration Agreement, PROJECT GUTENBERG SELF-PUBLISHING PRESS, http://www.gutenberg.us/articles/eng/Arbitration_agreement (last visited Nov. 15, 2017) (stating that German law excludes disputes over rental of living space from any form of arbitration but permits arbitration clauses in consumer contracts only if the arbitration clause is signed on a separate document that bears no other information other than the arbitration agreement).


207. Id.

208. Id. (quoting CODE DE LA CONSOMMATION [C. CON.] [CONSUMER CODE] art. L132-1 (Fr.).

better through state consumer protection laws without fearing federal preemption.\(^{210}\)

**B. The Dodd-Frank Act Should Impose a Rebuttable Presumption Against the Enforcement of Mandatory Arbitration Clauses in Consumer Contracts**

Legislation should reflect the inherently unequal bargaining power between consumers and commercial parties.\(^{211}\) In the United States, one way to do this would be to simply include additional provisions to the existing language restricting the use of mandatory arbitration clauses in consumer contracts.\(^{212}\) Currently 12 U.S.C. § 5518(b) provides as follows:

(b) Further authority

The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection(a).\(^{213}\)

It is suggested that the following provisions be added to 12 U.S.C. § 5518(b):

*There is a presumption that prohibition or restriction of mandatory pre-dispute arbitration is in the public interest and for the protection of consumers.*\(^{214}\) The burden of proof rests with the party seeking

\(^{210}\) See Stone & Colvin, supra note 209.


\(^{212}\) See infra notes 214-15 and accompanying text.

\(^{213}\) 12 U.S.C. § 5518(b).

\(^{214}\) See infra note 220 and accompanying text. Opponents may argue that imposing restrictions on mandatory arbitration in consumer contracts may adversely affect consumers. See George Calhoun, Arbitration Under Fire: Brace Your Company for Less Contract Freedom and More Class Actions, FTC BEAT (Mar. 31, 2016), https://ftcbeat.com/2016/03/31/arbitration-under-fire-brace-your-company-for-less-contract-freedom-and-more-class-actions. Skeptics of mandatory arbitration may argue, as follows, that limiting or restricting arbitration may be harmful for consumers:

By interfering with Americans’ freedom of contract to prevent the use of mandatory arbitration, the government could severely damage U.S. business interests by exposing them to a marked increase in expensive class action litigation. In turn, that would result
enforcement to prove that enforcing the arbitration clause would not violate public policy.\textsuperscript{215}

Other nations similarly restricted the use of mandatory arbitration clauses in consumer contracts.\textsuperscript{216} The legislation would act in much the same way as the Directive on Unfair Terms in Consumer Contracts ("Consumer Directive") issued by the Council of the European Union in 1993.\textsuperscript{217} Under the Consumer Directive, terms that were not individually negotiated in consumer contracts are considered unfair and therefore, not binding on consumers.\textsuperscript{218} Specifically, the following should be evaluated to determine whether a term is unfair:

Unfairness looks to the requirements of good faith and whether an arbitration clause causes a significant imbalance in the parties’ rights and obligations that acts to the detriment of the consumer. Terms must also be drafted in plain, intelligible language and consumers must have the opportunity to examine all contract terms.\textsuperscript{219}

The Consumer Directive creates a rebuttable presumption that predispute arbitration clauses in consumer contracts are invalid.\textsuperscript{220} Pursuant
to the Consumer Directive, courts of member states of the European Union must “presume that the arbitration agreement in consumer contracts is an unfair term, if it was not individually negotiated by the parties after the dispute arose.”\textsuperscript{221} The language of the Directive provides that a contract term would qualify as unfair provided that the both of the following conditions are satisfied: (1) the term creates a “significant imbalance” in the rights and obligations of the parties to the detriment of the consumer and (2) the imbalance created must be “contrary to the principle[s] [of] good faith.”\textsuperscript{222} However, “the official position is that any clause that causes a significant imbalance is by definition contrary to the principle of good faith.”\textsuperscript{223}

Since sophisticated attorneys typically draft consumer contracts, and the arbitration clauses in these contracts are usually included without giving effective notice to consumers, the United States should adopt a similar rebuttable presumption to restrict and limit the use of mandatory pre-dispute arbitration clauses.\textsuperscript{224} Moreover, legislation should reflect that consumers often do not seek legal advice before entering consumer contracts.\textsuperscript{225} As such, a rebuttable presumption should be adopted to restrict and limit the use of mandatory arbitration.\textsuperscript{226}

V. CONCLUSION

The use of mandatory pre-dispute arbitration clauses in consumer contracts is contrary to public policy and should be prohibited or, at the very least, limited.\textsuperscript{227} Despite the fact that sophisticated attorneys design arbitration agreements without giving effective notice to consumers, arbitration agreements involving commerce are generally held enforceable under the FAA.\textsuperscript{228} Although Congress intended for the FAA to target commercial parties of generally comparable bargaining power, courts have expanded the scope of the FAA as to include consumer


\textsuperscript{222} Maxeiner, supra note 222, at 134-35.

\textsuperscript{223} See supra Part III.A–B.

\textsuperscript{224} See supra Part III.A.

\textsuperscript{225} See supra Part IV.B.

\textsuperscript{226} See supra Parts III–IV.

\textsuperscript{227} See supra Part III.
contracts. Congress has established the CFPB in order to protect consumers. In addition, states have attempted to protect consumers through consumer protection laws. However, the FAA often preempts state consumer protection laws. As investor confidence is at the crux of health and stability of the economy, consumers should be provided more protection. Therefore, this Note proposes total prohibition of mandatory pre-dispute arbitration clauses in consumer contracts or additions to the existing law to limit the use of mandatory pre-dispute arbitration clauses in consumer contracts.

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229. See supra Parts III.C–IV.1.A.
230. See supra Part II.C.
231. See supra Part III.A.1.
232. See supra Part III.C.
233. See H.R. 1098, 114th Cong. § 2 (2015); supra Parts III.B, IV.
234. See supra Part IV.

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