



Editorial Memorandum:

Forced Arbitration Clauses Deny Justice to Consumers

By CPR Member Scholar [Martha McCluskey](#)

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Earlier today, the Consumer Financial Protection Bureau (CFPB) released a long-awaited proposed rule aimed at providing consumers with a measure of protection from the “forced arbitration” clauses that have become so common in consumer contracts with banks and other lending institutions. The financial industry writes these clauses into contracts for credit cards, auto and school loans, and other financial products in order to prevent consumers from exercising their right to hold these companies accountable in court. The evidence shows that they have the desired effect: funneling consumers into a rigged process that leaves them with no realistic chance of achieving justice.

The CFPB’s new rule grew out of a charge from Congress to review, and if warranted, regulate the use of such clauses. Studying the problem over the course of three years, CFPB found that forced arbitration clauses were in widespread use: 53 percent of regular credit card contracts have them, as do 86 percent of private student loan agreements and 92 percent of prepaid credit card contracts. It also found that the clauses, which frequently require consumers to bring complaints to an arbitrator chosen by the company, rarely resulted in compensation for consumers. For example, in claims over disputed debt, the CFPB study found that consumers prevailed only 14 percent of the time, successfully disputing an average of only five cents of every dollar of debt..

In addition, most consumers were unaware that the contracts prohibited them from pursuing complaints in court, making it impossible for them to seek out a bank or credit card company that did not restrict their rights with such a provision.

Stacking the Deck

The inability to hold financial companies accountable in court is just one problem with forced arbitration. The arbitration system itself is stacked against consumers.

- Companies that use forced arbitration clauses usually reserve the right to choose the arbitrator who will resolve disputes with the company. Arbitrators thus have a strong incentive to deliver favorable results for the companies in order to drum up repeat business.
- Other barriers to bringing a claim include high up-front fees that consumers must pay simply to file a claim, requirements that arbitration hearings take place in far-flung locations, shortened

deadlines for starting a claim (that is, a short “statute of limitations”), and arbitrary limits on the amount of relief that is available.

- Arbitration proceedings are conducted in secret, and consumers are prohibited from disclosing any details regarding their claims. But the businesses involved in these claims often have access to the details of past arbitration proceedings, which can give them a leg up when fighting other consumer claims.

Such problems came into play in 2007 when [Captain Matthew Wolf](#), U.S. Army Reserve, was called up to serve in Afghanistan. Captain Wolf tried to exercise his rights under the Servicemembers Civil Relief Act to end his car lease, but his request for a refund of \$400 in future lease payments he’d already made was rejected. Captain Wolf filed suit, but the auto manufacturer, Nissan, invoked a forced arbitration clause to have his case thrown out. He soon learned that pursuing his claim for \$400 could cost him as much as \$8,200 in fees.

New Restrictions on Forced Arbitration

The new CFPB rule does not prohibit forced arbitration clauses altogether. But it does ban the use of such clauses to bar class action lawsuits, meaning that when a number of consumers have similar complaints, they will be permitted to pursue them in court. The practical effect will be to make it feasible for consumers who’ve been cheated out of relatively modest sums to join together to press their cause in court.

However, the CFPB rule would not ban forced arbitration for claims brought on an individual basis, allowing companies to continue to evade accountability in cases where individual consumers seek justice.

A [new report from the Center for Progressive Reform](#), issued shortly before the CFPB rule was announced, anticipated — and lamented — that the agency would permit forced arbitration in such cases without at least some new consumer safeguards. The report observes that CFPB’s own study produced ample evidence that forced arbitration of individual claims also harms consumers in ways that defeats the public interest in promoting financial security for all. At minimum, according to the report, CFPB should restrict or prohibit the most anti-consumer features of the arbitration process, including excessive filing fees, prohibitive hearing location restrictions, harsh time limits for initiating claims, improper relief limits, and one-sided restrictions on choice of arbitrators.

The Empire Strikes Back

Not surprisingly, the financial services industry is firmly opposed to CFPB’s rule. They argue that it will increase prices and restrict credit. As it happens, the CFPB study tested this proposition and found it without merit. The CPR paper explains:

Critically, the agency was able to test industry’s contention that forced arbitration results in lower prices and expanded access to credit for customers by examining how four large credit card companies responded to a 2009 class action settlement in which

they agreed to refrain from incorporating forced arbitration clauses into their consumer contracts for a period of at least three-and-half-years. The CFPB found that the affected credit card companies did not raise their prices relative to their competitors that continued employing forced arbitration clauses. The CFPB also found no evidence suggesting that the affected credit card companies reduced the amount of credit they made available to potential customers, although the results were less conclusive based on the limited data available.

The report goes on to note that, “whatever cost savings the financial services industry might enjoy from forced arbitration are not being passed on to consumers in any meaningful fashion.”

In the end, the strongest argument for restricting forced arbitration clauses is that they make it harder for consumers to achieve justice when large corporations take advantage of them. The new CFPB rule represents an important step toward justice, although more work remains.

I hope you'll be able to find space on your opinion pages for this important topic. I'd be delighted to provide more information or answer any questions you may have. You can reach me via the CPR media office, by contacting Brian Gumm at bgumm@progressivereform.org or 202-747-0698, ex 4. You might also find [this fact sheet](#) useful.

Thanks very much for your consideration.

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