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MANDATORY ARBITRATION CLAUSES IN CONSUMER CONTRACTS

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ABSTRACT

The objective of the article is to analyze and examine the mandatory arbitration clause in a consumer contract. This article follows the Collective and doctrinal research method in which the compilation, interpretation, and systemizing the primary and secondary source of data has been done. The research has been done from the various articles and judgments from different websites of American and Indian Government which pinpoints the data that is collected. After collecting the data, the researcher conducted an in-depth analysis of the content through which it concluded that the data is historic, descriptive, and contains analytical views. The study of these articles is organized and systematized from the secondary source material.

However, every study has a limitation. The study of mandatory arbitration clauses in a consumer contract is very wide and extensive which is why it is impossible to study every judgment and article from different websites. Moreover, all the judgments and theories are not possible to be discussed and described in detail. Only the prominent portions are curved out from the websites and are mentioned in this article.

Further, it is apt to mention the discussion of the Supreme Court views with regard to the arbitration clauses. Moreover, it discusses the unfairness of the arbitration clause in the consumer contract. Furthermore, this article discusses the Indian Law compared to that of the United States of America. As a result, the article discusses the arbitrary power which the company or the entity holds.

INTRODUCTION

Under the growing number of disputes, the companies are resolving the consumer/employee dispute by way of arbitration. In the United States, at least all the consumers/employees are subject to mandatory arbitration. They are bound to sign the contract that already exists the arbitration clause in which the

consumer is unaware of it. The United States arbitration follows the Federal Arbitration Act which was enacted in 1925 to ensure the validity and enforcement of arbitration agreement in maritime transactions or contract evidencing transactions through commerce. In the United States, the courts have adopted the pro-arbitration proceedings and it will be always upheld whenever an individual challenge in the court of law.[1]

In a country like the United States, consumers and business authorities do not have equal power. These consumer contracts are generally perceived as a contract of adhesion. Further, these consumer contracts are drafted by a big shot sophisticated attorney, employed by the companies, and imposed the mandatory arbitration clauses without even giving proper notice. Moreover, the consumers are forced to arbitrate whenever the dispute arises and they were not given opportunities to bargain for any arbitration provision. In addition, the companies play bossy and force the consumer to agree on the arbitration clauses in order to do business with them. Therefore, the burden of proof in on the business entities in order to show the effect of Arbitration clauses exists in the contract of adhesion. Thus, this article will describe numerous cases, legal questions, and the flaws of the mandatory arbitration agreements.[2]

PRE-DISPUTE ARBITRATION CLAUSES

In the USA, the Mandatory arbitration clause requires one party and another to accept the pre-dispute arbitration clause. This arbitration clause helps the party to settle outside the court. They exist in the contractual agreement. The mandatory arbitration clause is a way to avoid corporate accountability to the consumer and binds them with pre-dispute arbitration. Therefore, consumers, even before they get to know the pros and cons of arbitration versus litigation, are dragged and forcefully bound with pre-dispute arbitration.

More so, the consumer might have to bear the cost which is very high in pre-dispute arbitration as compared to post dispute arbitration as in pre-dispute there is no competition on cost providers. However, in post dispute, the parties can negotiate with the service of arbitration providers.

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[1]Jon O. Shimabukuro & Jennifer A. Staman, *Mandatory Arbitration and the Federal Arbitration Act*, Congressional Research Service, 20 September 2017, available at https://fas.org/sgp/crs/misc/R44960.pdf.

[2]Katherine V.W. Stone & Alexander J.S. Colvin, *The arbitration epidemic*, Economic Policy Institute, 7 December 2015, available at https://www.epi.org/publication/the-arbitration-epidemic/#epi-toc-19.

Further, recently in the United States, due to the existing problem with the consumers in regard to the arbitration, there were some reforms in the mandatory arbitration clause. The United State's senator and Congressmen introduced the bill known as the Arbitration Fairness Act to reinstate the FAA (Federal Arbitration Act), the original intent. The key changes proposed and the most significant one is that 'No pre-dispute agreement shall be valid or enforceable if it requires arbitration of employment, consumer or franchise dispute or any matter related to the protection of civil rights. With this proposed bill, the AFA guarantees that there will be only arbitration when the dispute has arisen. Moreover, it also guarantees the disclosure of arbitration clause whenever the parties tend to resolve the dispute. Further, it will give the consumer an option to either litigate or go for arbitration. This will help the consumer to accumulate their problems to some degree.'[3]

CONSUMER FORBIDDEN OF PURSUING CONSUMER DISPUTE WHEN THERE IS ARBITRATION CLAUSE

Over the past years, the problem has become common regarding the insertion of the arbitration clause into the contract with the consumer. This has appeared to be innocuous but this clause lacks a powerful punch. The mandatory arbitration clauses prevent the consumer to go to court if they have a dispute. Rather, they proceed according to the arbitration clause and file a complaint to private institutions or forums in which they are less likely to prevail and recover their due. Therefore, consumers find it difficult to win their cases in the arbitration proceedings.[4]

Further, it is the forum that decides the fairness of protection in the arbitration proceedings. Moreover, the consumer can try and challenge the enforcement in the court but the ability to challenge is very limited. The awards given by the arbitrator are not appealable. Due to that reason, the consumer receives very little damages in arbitration as compared to courts. Further, in the past few decades, the courts have adopted pro-arbitration doctrines stating that arbitration clauses are always upheld when challenged in the court.

[3]Shelly Smith, *Mandatory Arbitration Clauses in Consumer Contracts: Consumer Protection and the Circumvention of the Judicial System*, 50, DE PLR, 1191, (2001) available at https://via.library.depaul.edu/cgi/viewcontent.cgi?article=1625&context=law-review.

[4] Joe Valenti, *The Case Against Mandatory Consumer Arbitration Clauses*, Centre for American Progress, 2 August 2016, available at https://www.americanprogress.org/issues/economy/reports/2016/08/02/142095/the-case-against-mandatory-consumer-arbitration-clauses/.

In fact, courts have also upheld the arbitration clauses even when the consumers show that arbitration proceedings are too expensive. As a result, important consumer disputes and their rights of the consumer can no longer be bought to the court subject to the mandatory arbitration clauses in the contract agreement.[5] Reliance is placed on the judgment of **Prima Paint Corp. v. Flood & Conklin Mfg. Co,** in which the Supreme court of the USA states that "When a party claimed that a contract it had signed was induced by fraud, that party had to assert its claim in arbitration. That is, even if the entire contract (in that case, a commercial lease) was invalid, the arbitration clause survived because, the Court found, the promise to arbitrate was separable from the rest of the contract. This holding is called the 'separability doctrine.'"[6]

UNFAIRNESS OF MANDATORY ARBITRATION CLAUSE

Mandatory Arbitration clause for the consumer is an unfair, discriminatory, and one-sided process. Mandatory arbitration clause and pre-dispute arbitration clause waived of the rights of the consumer to access the court. The problem that is faced by the consumers who are forced for the arbitration by contracts are given herein below:

The fee imposed by the mandatory arbitration clause may make it very expensive for the consumer as the arbitrator charges thousands of dollars in filing the case and also for the hearings. However, the consumers unable to pay the fee and precluded the remedy. Furthermore, the fee in respect is much higher than the claim of the consumer, and due to the employment dispute, the consumers are endangered from pursuing anti-discrimination claims.

Companies use mandatory arbitration clauses in order to avoid class action. Moreover, it is difficult for the consumer/employee with small claims to seek advice from any legal expert. Therefore, the companies gain a lot of benefits through this small gain to a large number of people.

The mandatory arbitration clause frequently selects the venue which favors the incorporation. In this way, the consumer/employee has to travel quite a lot to make their claim heard. The mandatory arbitration clause gives the power-hand to select the arbitrator from the arbitration organization. It is obvious that the company has established long term relationships with the arbitration company and thus in return the arbitration organization always favors the company. Moreover, the arbitration organization does not keep any public archives. Therefore, the

[5] *Supra* at 3.
[6] 388 U.S. 395.

consumer/employee is unable to check the biasness of the arbitrator, even when they have the same role in choosing the arbitrator.

There is a lack of public record in arbitration proceedings as there are no written submission and the facts and dispute raised in the arbitration proceedings must be kept confidential. There are no legal precedents and individuals cannot cite previous decisions to favors their case.

The parties in arbitration proceedings have very limited judicial review of an arbitration award but no review on the merits of the award. As it is mentioned above that there are no public records of any facts and laws made of the arbitration proceedings. Therefore, the burden of proof lies on the consumer to show the extraordinary biases and partiality of the arbitrator towards the company.[7]

Reliance is placed on the judgment of **Moses H. Cone Memorial Hospital v. Mercury Construction Corp**[8], when the US Supreme court states that, "when deciding whether a particular dispute comes within an arbitration clause, courts should resolve all doubts in favor of arbitration". It said that such a presumption furthered the "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary."[9]

VALIDITY OF MANDATORY ARBITRATION

The validity of mandatory arbitration in the United States goes back to when Federal Arbitration Act 1925 was enacted to ensure the validity and enforcement of the arbitration agreement in commercial transactions, consumer contracts, contracts evidencing a transaction involving commerce. However, the states have played a crucial role in the arbitration agreement and around 50 states along with FAA have governed the validity of the arbitration agreement. Further, the state legislature and the state court provided various restrictions on the arbitration agreement and proceedings particularly for the people who have unequal bargaining power between the parties.

The Supreme Court interpreted that Section 2 of the FAA "limits the grounds for denying enforcement of 'written provision[s] in … contract[s]' providing for arbitration," and due to this section, the FAA pre-empts the state law and judicial rule. However, the state legislature has tried to invalidate the mandatory arbitration clauses which they believe that the dispute settlement through arbitration would be unfair but the questions whether the FAA pre-empts the state

[7] *Mandatory Arbitration clause are discriminatory and unfair*, The Public citizen, available at https://www.citizen.org/article/mandatory-arbitration-clauses-are-discriminatory-and-unfair/.
[8] 460 U.S. 1 (1983).
[9] *Ibid.*

law or judicial rule has come numerous times in front of the state court and, in these cases, the courts always consider that FAA supersedes the state requirements to restrain the validity and enforceability of the mandatory arbitration.[10]

The United States Courts have given various judgment in regards to the validity of mandatory Arbitration Agreement. Reliance placed on the judgment **Red Cross Line v. Atlantic Fruit Company** is "believed to have opened the door for federal legislation that recognized the validity of arbitration agreements".[11] In a more recent case, **Preston v. Ferrer**, the Court held that "The FAA preempted a state law that initially referred certain state law claims to a state administrative agency before parties could arbitrate questions arising out of a contract. The Court ruled, in an 8-1 decision written by Justice Ginsburg, that the FAA preempted the state law."[12] In its opinion, the Court relied on an earlier FAA case, **Buckeye Check Cashing, Inc. v. Cardegna**, in which the Court determined "challenges to the validity of a contract providing for arbitration ordinarily 'should ... be considered by an arbitrator, not a court".[13]

Landmark judgment on **Southland Corporation v. Keating**[14] states that "the Court held that the Act superseded a state provision that effectively compelled resolution of a dispute exclusively through the courts. In enacting § 2 of the Federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration. "There were only two statutory exemptions: that it was applicable only a written maritime contract or a contract "evidencing a transaction involving commerce". Following the judgment on **Keating** as mentioned above the court has determined Section 2 of FAA that prescribes special conditions on the mandatory arbitration agreement. Further, under current construction, the states prevent the singling out of arbitration proceeding on the basis of suspect status. Therefore, the Supreme court also addresses the state law pre-emption under-saving clause of Section 2 of FAA in which states that "an arbitration agreement may be invalidated upon such grounds as exist at law or in equity for the revocation of any contract."[15]

COMPARISION OF US LAW WITH INDIA

[10] *Supra* at 3.
[11] 264 U.S. 109 (1924).
[12] 552 US 346 (2008).
[13] 546 U.S. 440 (2006).
[14] 465 U.S. 1 (1984).
[15] *Ibid.*

Arbitration clauses in consumer law in the country like the United States are omnipresent. However, in India, it is a different issue compared to other nations. In India, the Supreme Court gave a unilateral decision in regard to the issues related to unilateral arbitration clauses, employer and employee disputes, and consumer dispute.[16] Reliance placed on this judgment **Skypak Couriers Ltd. Etc. Etc v. Tata Chemicals Ltd** which state that "Even if there exists an arbitration clause in an agreement and a complaint is made by the consumer, in relation to certain deficiency of service, then the existence of an arbitration clause will not be a bar to the entertainment of the complaint by the Redressal Agency, constituted under the Consumer Protection Act since the remedy provided under the Act is in addition to the provisions of any other law for the time being in force".[17]

In the United States, consumer contracts are known as a contract of adhesion. It is when they have to pass the test of unconscionability. It is described from case to case basis or when the consumer is at a disadvantage and unequal bargaining power. However, in India reliance is placed on the judgment **Emaar MGF Land Limited v. Aftab Singh**, in which the Supreme court states that "The remedy of arbitration is not the only remedy available to a grower. Rather, it is an optional remedy. He can either seek reference to an arbitrator or file a complaint under the Consumer Protection Act. If the grower opts for the remedy of arbitration, then it may be possible to say that he cannot, subsequently, file a complaint under the Consumer Protection Act. However, if he chooses to file a complaint in the first instance before the competent Consumer Forum, then he cannot be denied relief by invoking Section 8 of the Arbitration and Conciliation Act, 1996. Moreover, the plain language of Section 3 of the Consumer Protection Act makes it clear that the remedy available in that Act is in addition to and not in derogation of the provisions of any other law for the time being in force."[18]

CONCLUSION

In the past decades, the Supreme Court enables the large corporation to forcefully apply arbitration proceeding for all sorts of disputes and violations, including violations of law for frauds, consumer wrongdoing, compensation of wages, protection of consumer rights, etc. Moreover, the courts also ask the corporation to make their own rules and regulation so that whenever the disputes arising out

[16] Payal Chawla, *NPAC's Arbitration Review: The validity of Mandatory Arbitration Clauses in unequal Contracting Relationships*, Bar and Bench, 25 Nov 2019, available at https://www.barandbench.com/columns/npacs-arbitration-review-the-validity-of-mandatory-arbitration-clauses-in-unequal-contracting-relationships.

[17] Appeal (civil) 2500 of 1994.

[18] REVIEW PETITION (C) Nos. 2629-2630 OF 2018 in CIVIL APPEAL NOS.23512-23513 OF 2017.

of the consumer contract then the corporation have all the power to adjudicate and settle the disputes. Further, the court permits the corporation to ban on class actions suits thereby preventing the consumers from challenging the corporate entity. However, FAA under Section 2 has a saving clause that provides such grounds in which the agreement is invalidated.

The Arbitration Fairness Act is currently under consideration before congress and yet to be introduced as a bill. It is the best hope to restore justice for the consumers. It is of utmost importance that this Arbitration Fairness Act gets the support of the majority so that it can protect the rights of the consumers.