

Can one-way contracts provide better consumer protection than the current enforcement-based regime?

Consumer Protection Without Law

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Suppose standard-form contracts between businesses and consumers were “one-way contracts,” enforceable only against one party, not the other. You probably think that I mean they would be enforceable only against businesses, not consumers — an extreme version of the consumer protection approach that has been percolating broadly. But I have in mind the opposite one-way contract, *enforceable only against consumers, not against businesses*. Consumers would be bound by contract, unable to escape any of their obligations or the fine print; they would have to pay the contract price, the hidden fees, abide by any restrictive provisions (as long as they are legal), commit to the full term of the service, and so on. Businesses, on the other hand, would not be legally bound to anything they promised, and aggrieved consumers would be unable to legally enforce any of their rights that appear in what we normally think of as the “contract” — not timely delivery, not the return policy, not the warranty, not even the conforming delivery itself. There would be no court-imposed remedy whatsoever.

How in the world can this make sense, even as a thought experiment? The reality of the market is already such that businesses have greater power and sophistication than consumers. Surely, consumers — not businesses — are the ones who need protection. Consumers are less informed, less well funded, plagued by collective action problems, and overall less able to secure compliance with their side of the bargain. If anything, contract law should remedy this asymmetry, not reflect it. So why should we consider stripping consumers of the power to sue for breach of promise, thus further disarming them vis-à-vis their mighty business opponents?

I argue that the concept of one-way contracts is a useful device to deliver two essential insights. The first insight is a descriptive metaphor, capturing much of the reality of business-to-consumer relations. The second insight is normative, suggesting that further gravitation toward a one-way contracts model could

actually benefit consumers. Rather than augmenting the legal remedies that consumers have under contract law (the stated goal of much consumer protection advocacy), we should think of other mechanisms that monitor business-to-consumer relations, which — unlike contract law — actually work.

THE PROBLEM WITH CONSUMER-TO-BUSINESS CONTRACTS

What can a consumer do when the business with whom he transacted breaches the deal? What if the business does not perform its obligation by, say, refusing to make good on a warranty or return policy? The prominent solution in contract law is enhanced enforcement. Consumers are able to file suits, seek remedies, and even to aggregate claims into class actions and secure substantial recoveries. But the impediments in the contractual setting are significant. Most claims are low value and are not worth the time and cost of legal proceedings. The ability to file large class action claims applies only to systematic violations. When the individual claims are small, members of the class are hard to identify and only a small compensatory effect is achieved. There is a non-trivial problem of separating the meritorious from frivolous shakedown suits. The fact is that despite a broad push for class litigation in state consumer protection laws, there is a prevailing sense that the consumer’s plight has not been answered by litigation.

Bolstering consumer protection through contract law runs into the additional problem that businesses can draft contracts that circumvent legal protections. For example, if the law tries to offer additional protection to consumers by increasing remedies, businesses can conspicuously limit the remedies. If the law installs procedures securing access to justice, businesses can draft their way out of court through choice of law and mandatory arbitration clauses. If the law finds such arbitration clauses unconscionable and vacates them, businesses make incremental changes to the clauses so as to make them legally tolerable. The target for consumer protection is elusive, the business parties are sophisticated and well counseled, and as long as the law is unwilling to fully reg-

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ulate the contract through mandatory terms, there is no clear solution. The trend in consumer protection advocacy is to search for more powerful remedial devices such as Federal Trade Commission enforcement and private class actions. Instead, I suggest, solutions can come from a different direction, replacing altogether the enforcement-based protections.

THE TEMPLATE

The basic feature of one-way contracts is simple: the terms of the transaction are enforceable only by one party, the business. Thus, if the consumer breaches the terms of the contract, say, by failing to make timely payment, the business can resort to legal remedies. The business can sue the consumer, employ collection agencies, and engage in any self-help measure that is legally available. But if the business breaches the terms of the contract, say, by failing to make timely delivery or by tendering non-conforming goods or services, the consumer cannot resort to legal remedies for breach of contract. Other legal claims, if available, may apply (tort, administrative, criminal), but not consumer-oriented contract remedies.

To illustrate:

- An airline would have the right to collect full payment from its passengers, but any promise the airline makes — to leave or arrive on time, or even to deliver passengers to the specified destination — would not be legally enforceable. None of the consequential harm to the passengers would be legally recoverable within a contract breach action.
- A phone company would have the right to collect timely payment for its services and any termination penalty that is valid under general rules of contract

law, but the company's obligation to provide adequate, uninterrupted service or to refrain from violation privacy concerns would be unenforceable.

- A seller of consumer goods would have the right to collect payment, but buyers would not have a legal right to enforce the express and implied warranties, the return policy, low price guarantees, and the like.

The absence of enforceable rights for consumers does not mean lawlessness. Even in a one-sided contract, the limits of the business's rights are clearly marked. The business is entitled to collect the posted price of the service, not more. If the business acts fraudulently and collects more, the consumer has a right to recover the funds in excess of the contractual obligation. This is the same remedy that protects one's property rights when they are illegally expropriated. Whether it is a stranger or a contractual partner that embezzled the consumer's money, recovery should be available.

One-way contracts deprive consumers of any contractual remedy, but they leave intact any other legal remedy that is not founded in the contract. First, some anti-consumer practices employed by the business are likely to violate state and federal consumer protection laws, anti-fraud legislation, and criminal laws. Those statutes often provide separate cause of action to victims, and otherwise empower state attorneys to mount a concerted enforcement effort. Second, businesses that embezzle their clients' assets, make unauthorized charges to their clients' accounts, or destroy the value acquired by consumers are committing torts. Here, the consumer's right to recover is not based on the contract, but rather on the absence of any contractual obligation in which the consumer agreed to part with the property.

Not all transactions between consumers and businesses need to be subject to the one-way regime. The most important exception is insurance contracts. While these are often standard-form contracts in which consumers have the classic passive, uninformed role, they do give consumers a large stake. When the insured risk materializes, the consumer has a large stake and a credible threat to sue (bolstered by the availability of punitive damages for opportunistic denial of claim). Here, contract remedies are both practical and intimidating.

CONSUMER PROTECTION SUBSTITUTES

Stripping consumers of the right to pursue legal remedies in the event of breach weakens their contractual entitlement and reduces its value. How would markets adjust to address consumers' insecurity? What protections emerge to substitute for the legal protection?

Redesigned Transaction Consumers are likely to be concerned about putting much money on the line when all they get is a promise that is not legally enforceable. Recognizing that they have no legal recourse, consumers might be reluctant to pay upfront and hope for timely, conforming delivery. Instead, consumers might require (and businesses might accord them) a different sequence of payments and commitments to reduce the magnitude of the consumers' losses in the event that they are cheated. One simple way to achieve this is to defer payment until some measure of consumer satisfaction is achieved. Consumers would be accorded a more substantial set of rights to inspect the value of the goods or services, and to reject those goods or services if they are non-conforming, all before making any substantial payment. Instead of paying and then relying on promises and assurances — the legal warranty that will no longer be binding — consumers would only have to pay upon some verifiable satisfaction.

In order to attract consumers, producers would have to enhance consumers' rights to inspect and reject goods. Producers could carve up transactions into many small pieces, effectively giving consumers multiple opportunities to exit. For example, a long-term cell phone contract would give way to a pay-as-you-go structure without any commitment, giving the consumer the right to pursue his reasonable expectations by switching to another provider. Or, products would be sold with free trial periods, or offered in "pieces" — leased rather than sold — thus reducing the consumer's anxiety about malfunction. Such designs allow consumers to rely on the simplest measure of "self-help" — stopping payment. Indeed, many companies already offer such arrangements. Trying to lure consumers who are weary of contractual commitments that are replete with unpleasant surprises, communications companies would be pushed to provide telephone and cable service that could be cancelled at any time without penalty. It is quite telling that the market term for these types of agreements is "No Contract Required." Consumers receive the desired protection with less contract, rather than more.

Not all transactions can evolve into piece-by-piece transactions or transactions that allow at-will termination by consumers. Cars, for example, are already offered for lease, but the

commitment required from the consumer is long, at least several years. A smaller commitment — car rental — is disproportionately expensive not only because of the transactions costs, but largely because of asymmetric information and incentive problems. But markets can experiment with small commitments that are not disproportionately costly. For example, many consumers rent Zipcars, shielded from any long-term commitment, without incurring a disproportionate cost and with surprisingly low transaction cost. Markets experiment with clever designs that reduce the transactions costs involved in carved-up contracts.

Private Bonds and Assurances If a transaction is perceived to involve some risk of non-performance or forfeiture, consumers can turn to private bonds and assurances to secure their payment. In some limited way, retailers already provide this service. If you buy a product at Macy's and find it lacking in any way, you can return it to the store with little hassle and receive a refund. The fact that the manufacturer made a defective product and refuses to repair it is of less consequence to the customer who can return to the retail outlet and receive adequate attention. High-end retailers bundle the sale transaction with some form of assurance and charge an appropriate premium, depending on the generosity of the plan. Discount outlets, on the other hand, often unbundle the two.

But what if the retailer itself is the irresponsible business? Again, market innovation provides solutions. On the Internet, intermediaries specializing in consumer protection services are already budding. SquareTrade, for example, warrants Internet purchases of electronics in a way that is relatively cheap and hassle free. It supplements the warranty term provided by the retailer or the manufacturer (probably the most important legal right that the consumer has) with its own repair-and-replace warranty. Its service is easy to price and to purchase, and claims are relatively easy to administer.

Similarly, credit card companies provide purchasers with purchase protection, usually restricted to a period of 90 days from the date of purchase. They do this in order to induce buyers to make purchases that they might otherwise not make, and to use the credit card as the form of payment. Other payment intermediaries do the same. For example, PayPal offers a Buyer Protection Plan that reimburses buyers for the full price and shipping costs in the event that they file a complaint against the seller that is found to be meritorious.

Market platforms provide protections to customers who enter their domains. For example, eBay Motors provides disappointed buyers a fund from which they can recover the lost payment if the seller defrauds them, up to \$50,000. This coverage is provided free for most of the vehicles purchased. As an intermediary between many buyers and sellers, eBay can monitor the conduct of sellers "on behalf" of the buyers. It can (and does) charge sellers for the cost of the buyer protection program, but it can differentiate the price according to the seller's record and it can expel sellers who breach their obligations, preventing future abuse. That is, eBay provides not only an insurance function, but also a monitoring and deterrence function. Sellers on eBay have strong incentive to pro-

tect the integrity of the market in which they are operating, so as to attract more buyers. Setting up their own dispute resolution procedures, intermediaries like eBay and Visa effectively operate as sophisticated enforcement agents for dispersed, unsophisticated buyers.

Insurance Like any measurable risk, breach of contract is a risk that might create opportunities for insurance. If the removal of legal remedies imposes greater risk on consumers, there would be increased demand for coverage against this type of hazard — an insurance arrangement against bad performance by the business. And if the patterns of this risk can be measured and predicted in a systematic way, insurance companies would supply this coverage.

Unlike the extended warranty services discussed above, the insurance coverage could be sold as an “umbrella” — applying to the entire defined class of business-to-consumer transactions

say, to blacklist any business that exhibits a record of high incidence of claims, refusing to insure its transactions in the future, and thus alerting consumers and rendering the non-performance risk more salient. Insurers can write exclusions such as “this policy does not cover purchases from Company X.” Because insurers can aggregate and share actuarial data on the non-performance risk that businesses pose, these blacklists can be reliable. Or, if blacklists are distasteful, a different practice can be to offer a menu of premiums: the insurance premium can be \$400 if it applies to all purchases, and only \$100 if several exclusions apply. Insurers, for example, can provide a list of businesses with whom the contracts are fully insured, and apply a significant deductible or cap to contract breaches with any business not on the list.

Ratings Rating services provide consumers with valuable information on the most important unknown: how satisfactory

Stripping consumers of their right to pursue legal remedies would give rise to substitutes that would address consumers’ insecurity.

that the insured would enter into during the term of the policy. It could attach, for example, to the consumer’s homeowners insurance policy as yet another covered risk — the “contract breach peril.” In this environment, insurers would likely take on duties that go beyond passive coverage. One obvious duty would be to manage claims and separate the valid from the frivolous. In many areas, this verification role is precisely the craft that insurers perform best. Medical insurance plans, for example, are often nothing more than claim administrators (the risks are borne by employers). Insurance investigators have superior access to evidence regarding the merits of any individual claim *ex post*, better than courts and surely better than the consumer service department of the business that sold the unsatisfactory product. And since the insurer has a significant sanction against frivolous claims — increased future premiums, forfeiture of other coverage — it can deter such claims better than other potential claim administrators.

Another obvious role for contract breach insurers is to efficiently underwrite the risk. Insurers have more information about the likelihood of a potential claim — the insured’s “propensity” to file claims — because they can keep records of the rate of past claims by the insured, or infer this from other correlated behaviors. Whereas the SquareTrade warranty can, at most, aggregate information about a particular seller or product, an insurer can cross the same information with each insured’s record. Moreover, insurers have an infrastructure for aggregating data across the industry, something that other assurance intermediaries do not have.

Insurers can deter bad behavior by business by threatening,

will their experience be. Relying either on experts’ evaluations or on aggregation of previous consumers’ experiences, ratings provide a prediction of future satisfaction. Ratings are already a deep-rooted market practice. For example, when reserving a hotel online, Expedia rates hotels along several attributes (e.g., cleanliness, service, comfort) on the basis of average customer reviews. When deciding how to vote in elections, voters can check how a candidate is rated by the Environmental Defense Fund or the National Rifle Association. When choosing a restaurant, Zagat provides a score and a simple breakdown of features that reflect the quality of the establishment relative to its cohort. When buying a new car, *Consumer Reports* provides a variety of ratings of performance, safety, durability, as well as overall recommendations. When purchasing goods from an online retailer, various intermediaries provide ratings that help shoppers predict the quality of the goods sold and the reliability. CNET, for example, refers buyers who search for electronic appliances to various retailers and models, rating each over a variety of parameters that affect consumers’ satisfaction, aggregating the experience of prior buyers. Likewise, eBay uses a well-known feedback rating of each seller, showing the number of prior sales, the percentage of satisfied customers, and its score over several dimensions of satisfaction. In fact, it is hard to think of market transactions that are not subject to consumer or expert ratings: movies, restaurants, music, new books, used books sellers, blenders, pizzas, coffee, dentists, even law professors.

The advantage of these ratings is that they put weight on those aspects that average consumers and users actually care

about most, the factors that predict the ex-post degree of satisfaction. Moreover, techniques that provide relevant and reliable aggregations are likely to continue to flourish. It is imaginable that even the producer's "contract" or the "legal" experience could be rated — how good is the warranty and repair service; how difficult is it to return the goods for replacement, repair, or refund; how effectively did the vendor respond to problems with the service; were there hidden fees and surprising burdens originating from the fine print; etc. To the extent that consumers want to know these issues in advance, ratings can provide such of information.

Ratings and similar reputation scores have become all the more important in electronic commerce, and the inner works of rating schemes have been perfected by successful web services like eBay, Amazon, and Expedia. The reason why Internet commerce relies so heavily on ratings and reputation is precisely that standard remedies for breach are significantly weaker in Internet transactions. Businesses are remote, unfamiliar, small, under-capitalized, sometimes deal in used or refurbished goods, and offer significant discounts — all are factors that normally increase consumers' apprehension and require extra assurances. There is nothing much the law can do to help a consumer who has been defrauded by a fly-by-night business. Contracts here are perceived to be one-way not by legal design, but by practical constraints. It is quite telling, therefore, how the pragmatic decline of traditional legal remedies went hand-in-hand with the phenomenal rise of ratings and reputation scores.

REAL ONE-WAY CONTRACTS

A one-way contracts regime is not as bizarre as it might initially seem. There are many consumer transactions that are largely done without a "contract," at least not one that protects the consumer.

Take, for instance, supermarket purchases. There is, of course, a legal contract between the consumer and the grocer. But unlike many other consumer transactions, in the supermarket there is no boilerplate involved, no web-launched "I Agree" pop-up, and no additional term-of-service record attached to the deal. How often do consumers sue supermarkets? And for what can they sue the supermarket? There are almost no contract disputes on record that required court proceedings, no damages, no express warranties, no risk-of-loss problems — in short, none of the staple legal issues that accompany contracts for the sale of goods. Instead, there is a deal: pay the price and the good is yours. Some supermarkets provide accommodations, such as an opportunity to return a faulty good after a reasonable chance to inspect it, often as a courtesy to customers and not because the grocer can otherwise be sued.

There are other prominent areas in which contract law plays no role. Consider taxicabs and restaurants. I did a digital search of the entire case law of New York and found no breach-of-contract cases that were successfully brought by consumers against taxi companies or restaurants.

To be sure, supermarkets, cab companies, and restaurants can have substantial legal liability to consumers: tort liability for injuries; fraud liability for deceptive practices, antitrust liability, liability under safety and sanitation regu-

lations, and more. In all these areas, enforcement — even if privately initiated — is viable because the magnitude of the remedy is substantial. But these claims redress other types of wrongs, not the breach of promise.

CONCLUSION

My purpose in this article is to go beyond some of the standard mantras of free market proponents, e.g., that competition among businesses or that education of consumers and disclosure of information can help bolster the integrity of consumer transactions and improve consumer satisfaction. Instead, I highlighted some additional devices, independent of competition and disclosure, that can substitute for legal protection of consumers.

My thesis is more ambitious than merely identifying several substitutes for contract enforcement. After all, the fact that substitutes exist is not a reason to eliminate one of the devices, however ineffective it might be. Instead, I believe that consumers can benefit from the elimination of the contract enforcement device. It is in the interest of consumers to transact within a legal regime that strips them of the power to seek contract remedies for breach, while at the same time reserving the business side's power to enforce contracts. The removal of one protection device would strengthen the other devices and would render consumer protection more robust overall. In the longer version of this paper ("One-Way Contracts: Consumer Protection Without Law," forthcoming in the *European Review of Contract Law*, 2010), I explain why the substitute protections would be slower to develop in the presence of perceived legal protection.

There is an important sense in which the one-way contracts idea is merely a thought experiment. The arguments developed here are exploratory in nature. I have not measured, either analytically or empirically, how much protection would be lost and how much would be gained by the removal of contract enforcement. Indeed, I left some of the boundaries as to the scope of this regime vague, precisely because the value of the contract enforcement device can vary. The payoff to this thought experiment, even if it does not deliver a ready-made formula for legislative reform, is the shedding of light on which factors matter when we talk about consumer protection.

While this article takes a highly skeptical view of the role of contract law in consumer protection, it is by no means an "anti-consumer" manifesto. On the contrary: the one-way contract thesis is friendly to consumer interests because it suggests that meaningful protection can and should be achieved by the design of more potent substitutes. Within contract law, the plight of consumers is often regarded as a basis for enhancing contract enforcement and of bolstering the access of consumers to breach of contract remedies. The one-way contract idea suggests that this is a misguided priority, barking up the wrong tree. Rather than paying lip service to consumers' "vindication of rights," "access to justice," or the right to be informed through mandatory disclosures, this article takes the reality of non-enforcement as given and considers ways to overcome it. It is the cultivation of more potent substitutes that could help consumers. R