Consumers & Complaints: Marketing Evolution Leads to Legal innovation from Contract Clauses to General Fairness

Ross D. Petty, Babson College[1]

While small purchases made with traditional (brick and mortar) retailers may have no formal contract beyond the exchange itself, the rise of internet "e-tailing" has led to online consumers clicking that they agree to standard form contract terms typically without actually reading the terms. In either situation, consumers might be dissatisfied with the purchased good or service and seek some sort of compensation such as a full or partial refund of the purchase price. A strict legal approach would call for examination of the contract terms to see if breach has occurred and whether the terms limit available remedies.

Contrary to this apparent internet-based increase in importance of consumer contract terms, this paper argues that consumer marketing, particularly over the internet, is evolving past resolving consumer complaints by adhering to contract terms that typically favor the seller. Rather marketers are using consumer in-house dispute resolution processes to innovate away from a contract enforcement model toward a customer satisfaction model in order to develop customer loyalty and retain future purchases. Agreeing to a settlement that the consumer perceives as fair also may lead to favorable online reviews and other forms of word-of-mouth brand promotion to attract new customers. When fully implemented this legal innovation essentially replaces the pre-sale imposition of standard form contract terms with the post-sale negotiation of a remedy to satisfy a complaining consumer.

This paper further suggests that this innovation should lead to changes in one sided consumer contract provisions that are no longer considered to be in the company's best interest. Furthermore, even if contract provisions that typically favor the marketer are not changed, it is possible that courts may refuse to enforce them if they are routinely ignored by the in-house customer service department.

Background

In the middle ages, consumer sales were straightforward –consumers inspected the proffered goods, negotiated over price, and purchased by payment to the seller immediately receiving the goods. In this age of *caveat emptor* all seller promotion was considered puffing –the expected vague commendation of the goods that was the opinion of the seller and not worthy of reliance by reasonable consumers. Any problems in the sale were worked out between the two parties who typically had an ongoing relationship with one another. As goods became more complex, the law eventually created an exception for *caveat emptor* in the form of warranty –factual statements by the buyer that were intended to be relied upon by consumers and therefor were legally binding upon the seller. If informal means failed to resolve differences, consumers could now sue sellers for breach of contract in the relatively rare cases where the seller had intended to create an express warranty.

However, as the market evolved to manufactured branded goods rather than goods that originated or were selected by retailers, and consumer credit became widely available, suing the seller often meant suing a largely unknown manufacturer who had ready access to litigation counsel and perhaps could only be sued in a distant location. Lawsuits were expensive and time-consuming and only financially justified for either expensive items or those who caused substantial consumer injury. In the 1950s and 60s business managers would avoid the expense of lawsuits against other businesses unless all other attempts to settle a breach of contract claim failed. However, at this time, consumers were treated differently than business channel partners. Consumers were no longer people known to the seller or even business "partners" like other channel members. They were just "sales" to be maximized. Mass marketing led to marketers employing a single standardized contract for the consumer masses. Such contracts are often referred to as contracts of

[1] Professor of Marketing Law and Faculty Research Scholar, Division of Accounting and Law, Babson College, Babson Park, MA 02457 USA, Telephone: 781 239 5529, Email: petty@babson.edu.

adhesion because they are imposed on consumers with no opportunity to negotiate terms. The fact that consumers had virtually no ability to negotiate over contract terms led to opportunistic behavior –marketers taking advantage of consumers with sales contract terms that favored the marketer.

Even if consumers could negotiate some aspects of the contract, they have little incentive to do so. Marketing firms may sell millions of items worth millions of dollars each year. They are willing to invest in drafting and negotiating favorable contracts and with standardized contracts, they can share the drafting costs and increase predictability of clause interpretations. Consumers, on the other hand, might buy several of a particular low-priced item each year and consider it unlikely that any problems will occur. They have little incentive to read much less negotiate terms for the contract.

Policy makers have struggled with the question of consumer contracts of adhesion. Various laws and regulations have condemned specific clauses as being unfair to consumers. However, traditional contract law calls for enforcement of contracts based on the mutual assent of both parties (assuming it is reely given without any underlying fraud). For this reason, attempts to develop general defenses to enforcement of adhesion contracts such as fraud, unconscionability, unreasonable expectations, good faith and public policy have enjoyed only limited success. In contrast, since 1925, U.S. courts generally have enforced arbitration clauses even for consumer contracts of adhesion. Arbitration tends to be faster and less expensive then judicial litigation.

Company Consumer Complaint Handling

The era of U.S. mass production of national brands was threatened by the rise of high quality Japanese imports in the 1980s. The U.S. industry responded to these high-quality products with its own quality and re-engineering movement. Quality started with listening to customers when designing new or improved products. At the same time, marketers began to study the value of customer retention as part of their interest in brand loyalty. The concept of customer and the importance of maintaining good customer relations became well understood. Eventually this led from listening to customers while designing products to also listening to customer complaints after purchase and attempting to satisfy those complaints and even considering them for product improvements. Toward the end of the last century, marketing shifted its orientation toward longer term relationships with customers. This shift was caused by the realization that repeat purchases were critical to long term success because retaining customers cost less than developing new customers. For many brands, one third of the buyers account for at least two thirds of the volume of sales. In order to maximize profitability, firms should attempt to retain these high value customers.

The consumer movement and marketer interest in building customer relationships led to the development of customer service departments. Initially, such departments were not very effective in satisfying complaining consumers since the apparent goal seemed to be minimizing the cost of complaints. A 1976 nationwide survey found that about one third of those surveyed experienced one or more consumer problems in the past year. Nearly 70% of those households with at least one problem submitted one or more complaints typically to the retailer or manufacturer. Nearly 70% of those complaining reported that their most serious consumer problem was not adequately addressed. A more recent survey in the 1990s still found that more than half of the surveyed consumers were dissatisfied with their complaint handling experience. However, the 1976 survey contained the seeds of legal innovation. It reported that 70% of consumers with small losses ($1-$5) and half of consumers with losses of $100 or more reported they would repurchase if their complaints were satisfactorily resolved. Surveys like this helped persuade many marketers that satisfied customers were often loyal customers and were consistent with evolving marketing theory regarding customer relationships.

The evolution of consumer complaint handling goals from cost minimization to customer satisfaction has led to largely ignoring pre-sale contact terms favoring the seller which are generally presented on a non-negotiable basis to consumers. Instead disputes are settled based on common perceptions of fairness. This legal innovation in complaint resolution occurred because marketers shifted from traditional mass marketing approach that emphasized attracting new customers to gain market share in favor of a relationship marketing approach that emphasizes building a relationship with customers to maximize their lifetime purchases.

Furthermore, recent studies suggest it is more profitable for firms to promptly satisfy consumers. One study suggests that the return on investment on effective complaint management can exceed 100%. Effective complaint management can not only help retain loyal customers, but also promote favorable word-of-mouth communications between consumers including favorable online ratings. A recent study concludes that complaint satisfaction is the main driver of loyalty for consumers who complain. Of those consumers who complain, most will purchase again if their complaint is resolved but those who receive excellent customer service are much more likely to purchase again and tell others of the favorable treatment.

Many firms have consumer complaint departments that handle the large number of complaints in one of two ways. First, many firms deal directly with complainants about their own product or service offerings. Second, online marketplace websites such as PayPal work to resolve disputes between consumers and sellers. For example, eBay handles 60 million disputes each year between buyers and sellers. The components of an effective complaint handing system are straightforward. Consumers want to feel they are being heard, treated promptly and with respect and the company will resolve the complaint in a way they perceive as fair rather than merely upholding some clause in a formal contract. It is as though the contract is being renegotiated after the fact in the complaint process. Such treatment builds trust with the consumer who is then more willing to continue making purchases.

Today many firms enjoy the lower costs and increased consistency of automated customer service. Computer algorithms analyze data to estimate behavior (does the customer make frequent returns?) and net worth of any particular complaining customer. Automated systems also can examine variations in past redress offered to similar customers to determine the likelihood of consumer loss in specific cases. As consumer marketing firms seek to maximize profits by choosing to do what is perceived as fair to customers rather than what is dictated in contract provisions, this raises the question of whether those contractual provisions should be changed to also reflect what is perceived as fair.

Whither Contracts?

As discussed above, lawyers for marketing companies have developed standardized consumer contracts that favor marketers in case there is litigation over contract terms. Such provisions also may influence consumer complaint behavior or the willingness of consumers to settle. However, such one-sided clauses also may lead to consumer defection to other brands or even online protest of unfavorable terms. It also is conceivable a court might hold that a firm has waived or repudiated those contract provisions –essentially that the firm is estopped from enforcing such long-ignored terms. While the doctrines of contractual waiver and repudiation and judicial estoppel have not yet been applied to such situations to the author’s knowledge, they all involve the question of whether it is unfair to enforce contract terms under particular circumstances. If a standard form contract is enforced against one consumer out of ten thousand, a court may someday have to decide if that such selective enforcement is unconscionable or against public policy.

This post sale negotiation to achieve consumer satisfaction should encourage firms that are seeking to enhance their customer orientation to no longer consider contract drafting as a win-lose proposition so that the side with the most bargaining power tries to dictate as many favorable terms as possible and still get agreement to the contract. Legally astute business managers who are attempting to implement a customer orientation throughout the firm should be mindful of lawyer contract drafting tactics and review current consumer sales contracts to make sure they are not only readable by consumers but also are perceived as fair by them. This paper proposes that consumer contracts should be shortened to their essentials and include a general good faith clause to the effect that the marketer will use good faith to attempt to settle every good faith complaint to the consumer’s satisfaction. If the two parties fail to reach an agreement, the contract may then call for arbitration or other forms of alternative dispute resolution.