# Introduction

The prevailing assumption in consumer contract scholarship is that sellers often take advantage of consumers’ imperfect information and rationality by introducing “one-sided,” welfare-reducing terms into standardized agreements.[[1]](#footnote-1) However, several prominent scholars have suggested that, in competitive markets, even “seemingly one-sided terms may not be one-sided after all.”[[2]](#footnote-2) Under this theoretical account [hereinafter: “the Gap Theory”],[[3]](#footnote-3) reputational considerations will constrain sellers from enforcing harsh terms to the letter against consumers, while the existence of these terms will allow them to fend off opportunistic buyers, who would take advantage of a more generous policy to extract benefits that the seller did not intend to offer.[[4]](#footnote-4)

While the Gap Theory has attracted significant scholarly attention, academics continuously debate both its descriptive accuracy and normative implications. First, some question the ability of competitive forces, and reputation in particular, to deter sellers from adhering to the four corners of the agreement when facing non-opportunistic buyers.[[5]](#footnote-5) Second, some argue that even if sellers are incentivized to depart from the letter of the contract when facing non-opportunistic consumers, the disparities between the “paper deal” and the “real deal” might lead to significant inefficiencies and harm consumer welfare.[[6]](#footnote-6)

This debate has significant policy implications. Those who believe in the ability of market forces, and reputation in particular, to discipline sellers and prevent them from behaving inefficiently, accordingly argue that policymakers and courts should not intervene in the contents of standardized agreements in the absence of observable market failures.[[7]](#footnote-7) In contrast, those who point to reputational failure or believe that the gap between the paper deal and the real deal might have adverse effects, call for more, not less, regulation in consumer markets.[[8]](#footnote-8)

Despite the significant practical implications of the debate, neither side can draw on any systematic empirical evidence to support its position.[[9]](#footnote-9) This Article represents an important step in filling this deficiency by exploring the Gap Theory in the field. It relies on retail stores’ return policies as a case study. Building on a combination of observational data and field experiments, this Article investigates potential discrepancies between the paper deal—retail stores’ formal return policies—and the real deal—retailers’ on-the-ground return practices.[[10]](#footnote-10)

Return policies have been used as the poster child example in the Gap Theory literature.[[11]](#footnote-11) The vast majority of the writings addressing the gap between the paper deal and the real deal have mentioned anecdotal evidence suggesting that retailers often behave more leniently towards consumers trying to make returns than the formal policy requires. It is therefore important to test the Gap Theory and its practical implications where gaps are most likely to be prevalent, and where they may significantly shape the relationships between sellers and consumers, as well as consumers’ perceptions, decisions, and outcomes.

More importantly, perhaps, by focusing on retail stores’ return policies, on paper and in practice, this paper informs the ongoing debate over whether and how to regulate consumers’ withdrawal rights.[[12]](#footnote-12) Should the law mandate a right to return, or should we rely on private arrangements? Despite the importance of the question and the great economic significance of product returns, far too little is known about the contents of return policies and how they are applied in practice.

This research provides critical insights for both policymakers and academics, making major contributions to the debate. First, using a hand-collected sample of online policies, in-store policy signs, and receipts from 193 national and local retail stores operating in Chicago, it provides the first comprehensive empirical account of return policies and their content across different types of retailers. Second, going beyond the paper deal, this author has administered a large-scale field experiment, in which pairs of testers (auditors), using a uniform script, were sent to try and return clothing items without receipts, despite a formal receipt requirement, to over one hundred stores in Chicago. This study provides the first empirical account of on-the-ground store practices, shedding important light on the interaction between contractual language and the contract in action, and the interchanges between sellers and consumers.

The Article proceeds as follows. Section I provides the background and motivation. It introduces the Gap Theory and the debate surrounding its descriptive validity and welfare implications. It reveals the importance of shedding empirical light on the debate in view of the opposing policy prescriptions that issue from each side of the controversy. It then proceeds to present the case study of product returns and the debate surrounding the need to regulate the right to withdraw from consumer transactions.

Sections II and III contribute to each of these two debates by providing the first comprehensive survey of retailers’ return policies on paper and in action. Section II focuses on the paper deal. It reports the findings of Study 1, which offers a systematic content-based analysis of 193 return policies. The findings reveal a significant variation in the contents of return policies that retailers offer. The results indicate that competitive forces incentivize sellers to compete over the terms of their return policies, and not only on product quality and price. Based on an overall policy leniency index prepared by this author, Study 1 also shows that more luxurious, established and (controlling for age) smaller stores offered more generous return policies to their customers. The finding that stores associated with higher prices offered, on average, better policy terms to consumers offers suggestive evidence that consumers are willing to pay for better terms, at least in contexts that are salient to them. Of course, the findings cannot be taken to prove a causal connection between prices and the quality of the policy terms. Yet, the fact that higher quality products are associated with better terms suggests that these terms are priced into the transaction.

Section III shifts attention to the real deal, the contract in action. It reports the findings of Study 2, a field experiment that this author administered using an audit technique. The findings reveal that, across a wide range of stores, a significant minority of retailers strategically departs from the paper deal in favor of consumers, These results are consistent with the Gap Theory, in that they suggest that sellers often deliberately adopt unconditionally harsh policies on paper, with the aim of screening out certain consumers, while departing from the agreement to please others. The findings also reveal that more luxurious and established stores are more likely to exercise leniency than are more casual, less established stores, even when controlling for the policy on paper.

Yet, as discussed in Section IV, the findings also raise some serious concerns as to the interaction between the paper deal, sellers’ on-the-ground practices, and consumer psychology. First, the results show that sellers typically refuse to depart from the harshest (“no refund”) policy terms, an area where we should arguably expect to find the most gaps. These results suggest that regulators should not rule out the need to regulate seemingly harsh terms based solely on the premise that sellers will not enforce them vis-à-vis one-time, non-opportunistic consumers.

Second, the findings reveal that stores vary in their departure or gap decisions, even when the paper contract and various store characteristics are controlled for. The Article argues that in view of inadequate informational flows, the observed variation might harm consumers’ decision making process both *ex ante,* prior to making the purchase, and *ex post*, when deciding whether to return a product to the seller. This is because consumers will be unable to distinguish between stores that offer better terms in practice and those that strictly adhere to their terms, and may therefore ultimately either enter into inefficient transactions or refrain from making efficient purchases. *Ex post*, this identification problem might discourage consumers from trying to make returns in stores that would actually be likely to depart from their unconditional paper policies in their favor, or it could lead to consumers inefficiently attempting to make returns in stores that would not budge.

Finally, the findings presented in Section II show that sellers use a complaint-based mechanism to segment consumers, while departing from the contract in favor of complainers twice as often as they do in favor of non-complainers. This Article acknowledges that sellers may apply complaint-based screening benevolently, using consumer assertiveness as a proxy for the merits of the claim or the value of the concession to the consumer. Yet, based on accumulating empirical evidence, this Article argues that this proxy might generate inefficient outcomes. This is because consumers are contract formalists, and are thus unlikely to complain when the seller refers them to the policy’s clear and unconditional language, even if the consumers have a valid claim, and even if the consumer’s benefit from the concession exceeds the costs to the seller of granting it. The Article proceeds to propose that the observed complaint-based screening might also yield regressive distributional effects. Evidence suggests that minority group members often feel less entitled, and are consequently less likely to complain than are people belonging to majority groups. Drawing on this research, the Article suggests that the gap may help those who are already better off, while harming less empowered consumers. Sections V and VI discuss policy implications, as well as implications for the field.

# I. Background and Motivation: The Gap theory and Gap Skepticism

## The Gap Theory

The Gap Theory suggests that apparently “one-sided” contract terms may persist in competitive consumer markets even in the absence of a market failure, because reputational forces will constrain sellers from enforcing these terms against most consumers, while the existence of these terms will protect sellers from opportunistic buyers.[[13]](#footnote-13)

Under this theory, sellers adopt one-sided terms in light of the inherent asymmetry between sellers and consumers. While sellers are constrained by reputational forces, buyers typically are not. Consumers may therefore abuse a seller’s policy term without incurring reputational costs, while sellers will not be able to insist on enforcing the policy to its fullest extent against the consumer without harming their reputations in the market.

 The Gap Theory reflects the broader belief in the ability of competitive market forces, and reputation in particular, to discipline sellers. According to Gap Theory proponents, reputational constraints will ensure that sellers selectively enforce harsh terms *only* against opportunistic consumers, while departing from the formal agreement to the benefit of the remaining, non-opportunistic consumers.[[14]](#footnote-14)

Sellers’ ability to adopt harsh terms on paper is important under this view, as courts are ill-equipped to distinguish between opportunistic and non-opportunistic buyers. Given the courts’ limited ability to identify the exact circumstances in a given case, it can be expected that sellers will offer contracts lacking terms benefiting the buyer. However, sellers will concurrently have an informal policy of allowing concessions not required by the contract. This descriptive theory therefore also has a normative prong: when consumer misbehavior is observable to sellers but non-verifiable, or verifiable only at a high cost to courts, the argument is that sellers should be allowed to use seemingly one-sided terms, since these terms will allow them to behave efficiently.[[15]](#footnote-15)

Importantly, according to the Gap Theory, sellers’ willingness to depart from one-sided contracts is not limited to interactions with repeat customers. Sellers that are repeat players in the market, with expectations of doing business with other consumers, may be discouraged from enforcing one-sided terms to the letter even if these sellers do not expect to have further dealings with the particular consumer.[[16]](#footnote-16)

Although the Gap Theory has gained considerable traction among legal scholars, it has recently been challenged on several grounds. First, its descriptive power has been questioned by those who argue that competitive forces might not adequately deter sellers from enforcing one-sided terms. These scholars rely mainly on the manifold evidence that informational flows in consumer markets are far from perfect.[[17]](#footnote-17) In fact, some claim that we have reached a point of “reputation failure,”[[18]](#footnote-18) because reputational information is neither reliable nor accurate, and is systematically skewed to the extremes.[[19]](#footnote-19) In addition, there are serious questions regarding consumers’ ability to accurately process reputational information and draw meaningful conclusions from it. The task of properly assessing reputational information is inevitably challenging because a seller’s reputation is affected by a myriad of factors, including the quality of the product, the quality of the paper contract, and sellers’ behavior in practice.[[20]](#footnote-20)

The effectiveness of reputational information becomes even more questionable in the particular context of the gap. It is unclear that consumers will be sufficiently incentivized to post information about sellers’ departures from the written agreement when reviewing a product online.[[21]](#footnote-21) Furthermore, even if online information is available, consumers might not be able to infer that sellers *systematically*, rather than sporadically, depart from the four corners of the agreement in consumers’ favor.[[22]](#footnote-22) Hence, sellers might have an incentive to enforce harsh terms to the letter even when dealing with non-opportunistic consumers.

A second line of attack involves the welfare implications of the Gap Theory. In particular, it has been argued that even to the extent that, as the Gap Theory predicts, sellers are incentivized to deviate from their paper contracts in favor of some consumers, these departures from the fine print may have welfare-reducing effects. Clayton Gillette, for example, has observed that sellers may use the gap to “create obstacles to recovery and then accede to the demands of the occasional insistent buyer, regardless of the underlying claim’s merit.”[[23]](#footnote-23) As a result, he noted that “sellers may find it profitable to begin with an inefficient contractual risk allocation” in order to “segment buyers.”[[24]](#footnote-24) Shmuel Becher and Tal Zarsky have similarly noted that “the Gap may distort consumers’ perception and undermine rational decision-making. The gap can undermine the correct allocation of risks and diminish overall efficiency. It may also be unfair, as well as contrary to other liberal values.”[[25]](#footnote-25)

This debate has important policy implications. Gap Theory proponents Lucian Bebchuk and Eric Posner have suggested that “courts would do well to take a hard line in enforcing the terms of one-sided consumer contracts in the absence of evidence of fraud.”[[26]](#footnote-26) At the same time, those who point to the potential adverse effects of the gap have suggested “regulating—or at least considering—not only firms’ ‘bad’ behavior (e.g., breach) but ‘good’ behavior (i.e., leniency) as well.” Finally, those who point to reputational failure highlight “the centrality of the law to the future of the marketplace.”[[27]](#footnote-27) Indeed, if sellers insist on adhering to the contract even when it is not socially desirable to do so, regulation of the contents of standardized agreements may be warranted after all.

In view of the conflicting policy prescriptions stemming from these theories, exploring them in the field is of outmost importance. Yet, notwithstanding the practical implications of this debate, empirical investigation into the gap is surprisingly lacking. This Article investigates potential discrepancies between the paper deal and the real deal, using the test case of product returns.

By focusing on retail stores’ return policies, on paper and in practice, this paper informs the ongoing debate over whether and how to regulate consumers’ withdrawal rights. The next section describes this debate, while also providing background to the study by briefly presenting the legal framework governing consumers’ withdrawal rights in the United States.

1. *See, e.g.*,Margaret J. Radin, Boilerplate: The Fine Print, Vanishing Rights, and the Rule of Law (2013) [hereinafter Radin] (noting that non-negotiable boilerplate terms regularly deprive non-drafting parties of their most basic rights); Edith Warkentine, *Beyond Unconscionability: The Case for Using “Knowing Assent” as the Basis for Analyzing Unbargained-for Terms in Standard Form Contracts*, 31 Seattle U. L. Rev. 469, 515 (2007) (observing that drafting parties often hide one-sided terms in their boilerplates); Oren Bar-Gill, Seduction by Contract: Law, Economics, and Psychology in Consumer Markets (Oxford U. Press 2012) [hereinafter Bar-Gill] (showing how sellers exploit consumers’ bounded rationality and systematic cognitive biases through contract design); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. Chi. L. Rev. 1203 (2003) [hereinafter Korobkin] (arguing that drafting parties have an incentive to introduce self-serving terms in view of the non-drafting parties’ bounded rationality); Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 Va. L. Rev. 565, 591 (2006) (“[I]f consumers . . . have no information (or only poor information) about the effect of the contract terms used by any individual seller, each seller will . . . have an incentive to degrade the “quality” of its terms.”); Nancy S. Kim, Wrap Contracts: Foundations and Ramifications 29 (2013) (suggesting that sellers use one-sided clauses, such as dispute resolution provisions, to hinder buyers’ access to the judicial system). For a similar claim, *see* J. Maria Glover, *Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements,* 59 Vand. L. Rev. 1735 (2006); Omri Ben-Shahar, **The Myth of the ‘Opportunity to Read’ in Contract Law**, 5 European Review of Contract Law 1 (2009). (outlining issues with consumers' ability to understand and comprehend contract terms and the rampant use of boilerplate or one-sided terms). (David A. Hoffman, **From Promise to Form: How Contracting Online Changes Consumers**, 91 N.Y.U. L. Rev. 1595, 1641 (2016). (explaining that "[t]he problem is that firms might be able to insist (in the law's shadow) that consumers comply with unenforceable [one-sided] terms, simply because those consumers misconstrue the operative rules."); David A. Hoffman, **Relational Contracts of Adhesion**, 85 U. Chi. L. Rev. 1395, 1396 (2018). (explaining that "[b]ecause consumers don't read their contracts, firms can make “hidden” terms worse without lowering prices.")  [↑](#footnote-ref-1)
2. Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 Mich. L. Rev. 827, 828 (2006) [hereinafter Bebchuk & Posner] (suggesting that “reputational considerations” may “induce the seller to treat the buyer fairly even when such treatment is not contractually required.”). [↑](#footnote-ref-2)
3. I collectively term the theoretical arguments made in the prior literature the “gap theory.” Previous writings that mentioned what I refer to as the “Gap Theory” include Clayton P. Gillette, *Rolling Contracts as an Agency Problem,* 2004 Wis. L. Rev. 679, 704-12 [Gillette 2004]; Bebchuk & Posner; Jason Scott Johnston, *The Return of the Bargain: An Economic Theory of how Standard Form Contracts Enable Cooperative Negotiation Between Businesses and Consumers*, 104 Mich. L. Rev. 857 (2006) [hereinafter Johnston] Robert A. Hillman & Jeffrey Rachlinski, *Standard Form Contracting in the Electronic Age*, 77 N.Y.U. L. Rev. 429, 441 (2002); Lisa Bernstein & Hagay Volvovsky, *Not What you Wanted to Know: The Real Deal and the Paper Deal in Consumer Contracts: Comment on the Work of Florencia Marotta-Wurgler*, 12 Jrsl. Rev. Legal Stud. 128, 129 (2015) [hereinafter Bernstein & Volvovsky]; Zamir, Eyal, *Contract Law and Theory: Three Views of the Cathedral*, 81 U. Chi. L. Rev. 2077 (2014); Clayton P. Gillette, *Pre-Approved Contracts for Internet Commerce*, 42 Houston L. Rev. 975, 977 (2005) (“On the seller side, sellers who attempt to capture the marginal buyer, who face reputational constraints, or who cannot distinguish readers from non-readers, will face competitive pressures inconsistent with efforts to exploit nonreaders. Such sellers will be more likely to price terms that allocate risks to buyers and to enforce ostensibly oppressive terms only in the face of serious buyer misbehavior. Indeed, the primary role of such clauses may be to provide sellers with discretion to treat buyers who appear to be acting in good faith differently from those who appear to be acting opportunistically.”); Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 Mich. L. Rev. 215, 281 (1990) (“Having the terms [unfavorable to the consumer] in the writing gives a seller the discretion to invest in goodwill in circumstances where it is most valuable to do so, while leaving him the option of enforcing the contract to the letter at other times.”). For a similar claim in the context of franchise agreements, see Benjamin Klein, *Transaction Cost Determinants of “Unfair” Contractual Arrangements*, 70 Am. Econ, Rev. 356, 358-60 (1980); Douglas Baird, Reconstructing Contracts, at 129 (“For all I knew, Norm had a form that disclaimed the implied warranty of merchantability, but such a disclaimer was irrelevant as long as reputational forces ensured that he would make amends if his goods did not pass in his trade.”). [↑](#footnote-ref-3)
4. See citations at foonote 3. [↑](#footnote-ref-4)
5. *See, e.g.,* Yonathan A. Arbel, *Reputation Failure: The Limits of Market Discipline in Consumer Markets*, Wake Forest L. Rev. (forthcoming 2019); Becher & Zarsky, Minding the Gap (2019); Ash –could you find more here? [↑](#footnote-ref-5)
6. Becher & Zarsky, Minding the Gap (2019); Ash –could you find more here? [↑](#footnote-ref-6)
7. Bebchuk & Posner; Johnston; Gillette? Find more citations from Arbel Article. [↑](#footnote-ref-7)
8. Becher & Zarsky, Minding the Gap. [↑](#footnote-ref-8)
9. See Becher & Zarsky who acknowledge the empirical deficiency and call for empirical work on these issues. Ash—could you add the exact citation here? [↑](#footnote-ref-9)
10. I borrow the terms “paper deal” and “real deal” from Lisa Bernstein and Hagay Volvovsky, who suggested that “studies of consumer contracts in particular contexts should move from looking almost exclusively at the terms of the paper deal to looking at the terms of the real deal.” *See* Bernstein and Volvosky, at 129. [↑](#footnote-ref-10)
11. Bebchuk & Posner; Becher & Zarsky; Jonston. [↑](#footnote-ref-11)
12. Ben-Shahar, Omri, and Eric Posner, *The Right to Withdraw in Contract Law*, 40 J. L. Stud. 111 (2011); Ben-Shahar & Bar-Gill, Regulatory Techniques in Consumer Protection (2013). Ash –could you find more citations based on Ben-Shahar’s paper? [↑](#footnote-ref-12)
13. Bebchuk & Posner [↑](#footnote-ref-13)
14. Bebchuk & Posner; Jonston; Gilllette. [↑](#footnote-ref-14)
15. Gillette Rolling Contracts 2004, p. 704; Becbuck & Posner. [↑](#footnote-ref-15)
16. Bebchuk & Posner 2. [↑](#footnote-ref-16)
17. Zamir & Teichman; Arbel; Becher & Zarsky. [↑](#footnote-ref-17)
18. Arbel. [↑](#footnote-ref-18)
19. Arbel, Reputation Failure, at 5. [↑](#footnote-ref-19)
20. See, e.g., [↑](#footnote-ref-20)
21. Cite Becher & Zarsky. [↑](#footnote-ref-21)
22. See Becher & Zarsky, Minding the gap, at 14; Becher & Zarsky, E-Contract Doctrine, at 342. [↑](#footnote-ref-22)
23. Gillette, Rolling Contracts, 707. [↑](#footnote-ref-23)
24. Gillette 706-707. [↑](#footnote-ref-24)
25. Becher & Zarsky, at 3. [↑](#footnote-ref-25)
26. Bebchuk & Posner. [↑](#footnote-ref-26)
27. Arbel [↑](#footnote-ref-27)