Daniel Castro
Vice President, Information Technology and Innovation Foundation
Director, Center for Data Innovation

"Zero Stars: How Gagging Honest Reviews Harms Consumers and the Economy"

Before the
Committee on Commerce, Science, and Transportation
U.S. Senate

November 4, 2015

Chairman Thune, Ranking Member Nelson, and members of the committee, I appreciate the opportunity to appear before you to discuss the impact of non-disparagement clauses on consumers and businesses. My name is Daniel Castro. I am the vice president of the Information Technology and Innovation Foundation (ITIF) and director of ITIF's Center for Data Innovation. ITIF is a nonpartisan, non-profit think tank whose mission is to formulate and promote policy solutions that accelerate innovation and boost productivity to spur growth, opportunity, and progress.

In my testimony today, I would like to discuss how the non-disparagement clauses that many businesses include in consumer contracts discourage consumers from providing honest feedback about products and services; why that harms consumers and businesses alike; and what Congress can do to address the problem.

SOME BUSINESSES USE NON-DISPARAGEMENT CLAUSES TO UNFAIRLY SILENCE CRITICS

Imagine that a patient has endured a terrible visit to the dentist. Disturbed by the ordeal, she goes online and posts a review, providing a factual account of her experience as a warning to future patients. Soon after, the patient receives a letter from the dentist's lawyer stating that she is in violation of a contract she signed during her visit and threatening legal action if she does not immediately take down the post. Shockingly, she discovers that buried in the paperwork she filled out was a clause prohibiting her from making any negative statements about the dentist. Scared that she may have done something wrong, and worried about the cost of going to court, the patient quickly deletes her review. Not only has this patient had her voice unfairly silenced, but many other potential patients will not be able to benefit from her experience by choosing a better dentist.

This scenario is one that an untold number of consumers have faced. A company will insert a clause into a standard contract that prohibits consumers from making any negative statements about the company and its products or services. Most consumers sign these agreements without noticing the non-disparagement clauses. Only later, if at all, do they ever realize what they have agreed to. For example, health care providers may ask patients to sign "mutual privacy agreements" that are less about protecting patient privacy (since federal laws already provide these protections), but instead are designed to prohibit patients from making negative comments about the health care provider.[1]

Alternatively, a company may demand that an unhappy customer sign a non-disparagement agreement before the company will provide a refund or exchange.[2] In both cases, companies may sue consumers for monetary damages if they subsequently make negative public comments about their products or services.

While there are no good estimates of how many consumers have been silenced by these non-disparagement clauses or how many companies regularly insert these clauses into their contracts, there are many well-documented cases of this problem arising in a variety of industries, including health care, retail, and hospitality. For example, one party rental company included the following terms in its standard contract: "By signing this contract, you are agreeing that you will not make or encourage any disparaging comments about [the vendor] ever in any form verbal or written."[3]

These non-disparagement clauses are particularly problematic because they are appearing in non-negotiated consumer contracts and even website terms of service without giving consumers a reasonable opportunity to negotiate or refuse to accept the conditions.[4] For example, if a consumer orders a coffee cup from a website, receives a broken cup, and is not satisfied with the company's response to his inquiries, he may decide to post a negative review of the website online. If the company has written a non-disparagement clause into the terms and conditions of either the sales contract or the website itself, mandating that customers do nothing to damage the reputation or services of the company, it may elect to sue its customer for breach of contract due to his negative review, even if the review is accurate. Indeed, the consumer may not even be allowed to post a photo of the broken cup.

The owners of the website KlearGear.com were brought to Utah's federal district court over a non-disparagement clause the website placed in its terms of sale "in an effort to ensure fair and honest public feedback."[5] A couple who never received their order and left a negative review on the website Ripoff Report was contacted several years later by KlearGear with a demand for $3,500 for violating the non-disparagement clause.[6] The Utah court found in favor of the reviewers, awarding over $300,000 in compensatory and punitive damages, but other consumers elsewhere may not be so fortunate. As a result of this highly publicized case, some states have begun enacting legislation to protect their citizens from non-negotiated non-disparagement clauses. For example, California recently passed a law prohibiting non-disparagement clauses in consumer goods or services contracts—unless they are knowingly and voluntarily negotiated.[7]

NON-DISPARAGEMENT CLAUSES UNDERMINE THE FUNCTIONING OF DIGITAL MARKETS, HURTING CONSUMERS AND BUSINESSES

One of the defining features of the digital economy is that customers can provide ratings of companies, products, and services—a phenomenon frequently referred to as the "wisdom of the crowd." Pioneering online services like Amazon, TripAdvisor, and Yelp, as well as many other websites, empower consumers to make more-informed decisions by presenting this crowd-sourced information alongside merchants' own descriptions of their products and services. This feedback is especially important when consumers are making purchases online, since they will not always have had the opportunity to evaluate products or sellers in person. Indeed, multiple empirical studies have found that customers rely on consumer reviews to make purchasing decisions and that better reviews lead to greater sales.[8] For example, one study found that a one-star increase in a restaurant's rating on Yelp led to a 5 percent to 9 percent increase in revenue.[9] Not surprisingly, many of the newest, rapidly growing Internet-based businesses, such as Uber, Airbnb, and Etsy, have integrated user-feedback as a key feature of their digital platforms.

A major purpose of reviews is to create an effective feedback loop: Consumers buy a product or service, and then review it online or elsewhere, so that other consumers can take those reviews into consideration before making purchases. Companies can change their products or services in response to compliments and complaints—and then, when they improve poorly reviewed features or add new ones, consumers can provide new reviews. Or other consumers, now empowered with more accurate information in the marketplace, can choose to buy from another company. Limiting these reviews to only positive feedback (i.e., comments that would not damage the company's reputation), significantly reduces the benefit of these processes for consumers, because they lose access to accurate information and may make suboptimal purchasing decisions.

Companies gain important insights about how best to meet the needs of their customers by data mining customer reviews. These tools depend on accurate and complete information. For example, L.L. Bean purportedly investigates products that continually receive ratings of less than three stars. After a certain variety of fitted sheets received a large volume of negative online reviews, the company found a manufacturing defect, took the sheets off the market, and offered 6,300 new sets to customers who had purchased the faulty variety.[10]

If companies are not receiving negative feedback, then they are not using this feedback to improve their offerings, and consumers are receiving lower-quality goods and services.[11] Indeed, one recent study found that after hotels begin responding to online user reviews, regardless of whether the reviews are good, neutral, or negative, they begin to receive higher ratings from guests—presumably because hotel managers are incorporating customer feedback.[12] Another e-commerce solutions provider found that customers who saw a company response to a negative review were almost twice as likely to make a purchase as those who saw negative reviews without a company response; and overall opinion of the product became twice as positive.[13] Thus, the opportunity to share honest reviews can benefit companies and service providers by offering a quality-control platform, and it can benefit consumers by offering an opportunity to air grievances and have them addressed.

Accurate reviews improve the functioning of markets. Indeed, it has long been an axiom in economics that markets work best when both parties—the buyer and the seller—have more information. In particular, better information enables consumers to make better choices. Some of those choices may result in some companies or service providers going out of business or losing business as potential customers learn of the poor quality of their products and services and opt to buy elsewhere. But by definition, this means that the market share of more efficient or higher-quality sellers increases, thereby maximizing overall economic welfare.

Some companies may be concerned about how false reviews can unfairly hurt their businesses, and this is a legitimate concern as their employees' jobs and welfare also are at stake. Competing businesses may try to manipulate consumer opinion by posting fake reviews—either positive ones for their own products and services or negative ones for a rival's.[14] The answer to this problem is not to limit all negative reviews, but rather to minimize those that are false or misleading.

Online platforms recognize the importance of accurate reviews for their users, and so they have invested in technology to detect fraudulent reviews.[15] For example, Yelp automatically filters out reviews that it suspects are fraudulent, and the site even issues pop-up alerts to consumers who visit the profile page of a business that it has caught buying fake reviews.[16] Some state attorneys general have also fined businesses for posting fake reviews as this violated their truth-in-advertising laws.[17] While digital platforms have taken many steps to limit bias in online reviews, if some businesses are using anti-disparagement clauses to silence their critics, then online reviews for these industries will be misleading and consumers will be worse off.

CONGRESS SHOULD PROTECT CONSUMERS' RIGHT TO REVIEW

Using non-disparagement clauses to silence negative public feedback undermines a key part of the digital economy and makes many consumers and business worse off. Given the clear negative impact of biased reviews for both consumers and businesses, Congress should intervene to prohibit these clauses in consumer contracts. Specifically, Congress should pass the bipartisan Consumer Review Freedom Act of 2015, introduced by Sens. John Thune (R-SD), Brian Schatz (D-HI), and Jerry Moran (R-KS), which would take two important steps to address this problem. First, the legislation would void anti-disparagement clauses in consumer contracts if they restrict consumers from publicly reviewing products or businesses in good faith. Second, the legislation would authorize the Federal Trade Commission to take action against businesses that insert these provisions into their contracts for engaging in unfair and deceptive practices.

Moreover, this legislation would still allow companies to take action against individuals who post false and defamatory reviews. In addition to bringing defamation cases against individuals who post patently false statements about their products and services, companies also can work with platforms to remove false statements. Virtually every online platform includes terms of service prohibiting unlawful statements and provides a mechanism to help business owners have untruthful statements removed. For example, business owners can flag potentially fake reviews on Yelp with a single click.[18]

Notably, this legislation takes a narrow approach to address a very specific consumer harm. The legislation would not apply to non-disparagement clauses found in voluntarily negotiated agreements, such as employment agreements or divorce settlements, where parties may have a legitimate interest in agreeing to certain terms.

CONCLUSION

Protecting people's speech is important first and foremost as a First Amendment issue. Protections, such as those offered in the Consumer Review Freedom Act, would help ensure that individuals have the right to engage in lawful forms of speech and that others can benefit from the information conveyed in this protected speech. In addition, protecting online speech, especially complaints or criticisms, is necessary to ensure that online markets function efficiently by giving consumers access to unbiased feedback about the products and services they research. While states have made some progress in laying the foundation for legislation prohibiting non-disparagement clauses, the U.S. Congress should step in to create a baseline of protection for all citizens' basic rights to freedom of expression in the digital marketplace.

REFERENCES

1. Lucille M. Ponte, "Protecting Band Image or Gaming the System? Consumer 'Gag' Contracts in an Age of Crowdsourced Ratings and Review," *William & Mary Business Law Review* (forthcoming), March 16, 2015, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2579172.
2. Ibid.
3. Chris Morran, "Wedding Company Contract Tries To Ban Bride & Groom From 'Encouraging' Negative Feedback," *Consumerist*, April 20, 2015, http://consumerist.com/2015/04/20/wedding-company-contract-tries-to-ban-bride-groom-from-encouraging-negative-feedback/.
4.. Noah Davis, "The Yelper and the Negative Review: the Developing Battle Over Nondisparagement Clauses," *American Bar Association*, Vol. 3, No. 10, May 2014, http://www.americanbar.org/publications/gpsolo_ereport/2014/may_2014/yelper_negative_review_developing_battle_nondisparagement_clauses.html.
5. Chris Morran, "KlearGear.com Ordered To Pay $306K To Couple Who Wrote Negative Review," *Consumerist*, June 26, 2014, http://consumerist.com/2014/06/26/kleargear-com-ordered-to-pay-306k-to-couple-who-wrote-negative-review/.
6. Ibid.
7. California Assembly Bill No. 2365, Unlawful contracts, § 1670.8 (2014), http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB2365.
8. Judith Chevalier and Dina Mayzil, "The Effect of Word of Mouth on Sales: Online Book Reviews," *Journal of Marketing Research* (August 2006), 345-354, https://msbfile03.usc.edu/digitalmeasures/mayzlin/intellcont/chevalier_mayzlin06-1.pdf.
9. Michael Luca, "Reviews, Reputation, and Revenue: The Case of Yelp.com," *Harvard Business School* (2011), http://www.hbs.edu/faculty/Publication%20Files/12-016_0464f20e-35b2-492e-a328-fb14a325f718.pdf.
10. Shelly Banjo, "Firms Take Online Reviews to Heart," *Wall Street Journal*, July 29, 2012, http://www.wsj.com/articles/SB10001424052702303292204577517394043189230.
11. Erin Mulligan Nelson, "Why Terrible Online Reviews Are Actually Good For You," *Advertising Age*, September 15, 2011, http://adage.com/article/digitalnext/terrible-online-reviews-good/229790/; Shelly Banjo, "Firms Take Online Reviews to Heart."
12. Davide Proserpio and Georgios Zervas, "Online Reputational Management: Estimating the Impact of Management Responses on Consumer Reviews," *Boston University School of Management Research Paper* (2014), September 27, 2015, http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2521190.
13. "The Conversation Index," *Bazaar Voice*, Vol. 6, accessed April 2, 2015, 11, http://media2.bazaarvoice.com/documents/Bazaarvoice_Conversation_Index_Volume6.pdf.
14. Dina Mayzlin, Yaniv Dover, and Judy Chevalier, "Promotional Reviews: An Empirical Investigation of Online Review Manipulation," *American Economic Review* 104 (2014), 2421-55.
15. Michael Luca and Georgios Zervas, "Fake it Till You Make It: Reputation, Competition, and Yelp Review Fraud," *Harvard Business School,* May 1, 2015, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2293164.
16. Eric Singley, "Consumer alerts: because you might like to know…" *Yelp Official Blog*, October 18, 2012, http://officialblog.yelp.com/2012/10/consumer-alerts-because-you-might-like-to-know.html.

17. Julie Bort, “New York Attorney General Busts 19 Companies For Writing Fake Yelp Reviews”, *Business Insider,* September 23, 2013, http://www.businessinsider.com/new-york-cracks-down-on-fake-yelp-reviews-2013-9.
18. See Yelp, “Terms of Service,” October 13, 2015, http://www.yelp.com/static?country=US&p=tos.