

## **SUBSCRIPTION-BASED BUSINESS MODELS: AN OVERVIEW OF AUTO-RENEWAL REGULATIONS**

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The demand for subscription-based and recurring revenue business models is growing faster than ever. According to a 2014 report by The Economist Intelligence Unit, 80 percent of customers are demanding new consumption models including subscribing, sharing, and leasing. As a result, most companies are changing, or are in the process of changing, how they price and deliver their goods and services. With 6.8 billion potential subscribers on mobile, social and web, the market is ripe for the business models first made popular by companies such as BirchBox and Dollar Shave Club.

A natural corollary to the recurring revenue streams driven by subscriptions is the need to comply with laws regulating purchases that automatically renew. While subscription services (sometimes referred to as auto-renewal programs) can be lucrative, companies should be mindful of the applicable laws to avoid the costs of fighting off the type of lawsuits that led to Sirius XM Radio settling an auto-renewal case for \$3.8 million and Angie's List settling a similar suit for \$2.8 million.

### **AUTOMATIC RENEWAL REGULATION**

Automatic renewal programs are regulated by both the federal government and individual states. Federally, automatic renewal programs are regulated by the Federal Trade Commission under 15 U.S.C. Section 41, et seq. and the Restore Online Shoppers' Confidence Act. Under these regulations, the FTC and the attorney generals for individual states have enforcement authority to bring actions against companies in violation of these rules.

On the state level, at least 24 states have enacted statutes regulating automatic renewals to varying degrees. While these statutes vary in strictness and scope, they generally require companies to disclose automatic renewal policies in a "clear and conspicuous" manner. Additionally, some states require companies to obtain customers' affirmative consent before charging a credit card and to disclose how to cancel the subscription to avoid future recurring payments.

Although the requirements are slightly different in each jurisdiction, states that regulate automatic renewal programs generally fall into three main categories:

1. Regulations that apply to contracts with individual consumers, not business to business contracts, and require only clear and conspicuous disclosure of auto-renewal terms (*e.g.*, California, North Carolina, Louisiana and Oregon);
2. Regulations that apply to contracts with individual consumers, not companies, and require clear and conspicuous disclosure of auto-renewal terms and require a service provider to notify its customer in advance of the auto-renewal (and cancellation deadline) within a certain period of time before the cancellation deadline (*e.g.*, Connecticut, Florida, Illinois, and Hawaii); and
3. Regulations that only impose requirements for specific types of contracts, such as, for example, contracts for health club memberships or home security services (*e.g.*, Arkansas, Maryland, South Carolina, South Dakota and Tennessee).

The state legislation has various penalties, which at a minimum void the contract with the consumer and in some situations also impose a monetary penalty for each violation. Although certain states, such as California, do not provide for a private right of action under the current regulations, almost every state mandates that customers be reimbursed for any services or products they purchased in violation of the law.

## DISCLOSURE AND NOTICE REQUIREMENTS

The regulations generally have two types of requirements: (1) disclosure requirements that regulate the manner, procedure and contents of the automatic renewal provisions during the initial purchase; and (2) requirements for written reminders that notify the consumer in advance that their service contract is set to renew for another term and that they must cancel if they do not wish for renewal to occur.

Disclosure requirements for most states require that the automatic renewal policy is displayed “clearly and conspicuously.” FTC guidance generally recommends that service providers use fonts, colors, and backgrounds that are easy to see and read. Some states also have disclosure requirements that regulate the content of the message, which includes the disclosure of all material terms, including the length of the automatic renewal term and the amount the charge may change during a renewal term (if applicable).

In addition to ensuring sufficient disclosure of automatic renewal provisions, some states also have statutory reminder notification requirements. These regulations require companies to implement a process by which customers will receive proper, advance notice of renewal under their particular agreements within the required time period before their right to cancel expires.

Certain states require these renewal reminders to be within a certain time frame of the customer’s deadline to cancel the automatic renewal. Some states also require that the renewal reminders have certain content. For example, New York requires that the notice calls attention to the renewal provision in the particular agreement, while Wisconsin requires the notice to include the deadline for

customers to decline renewal or extension and a description of any increase in charges for the renewal term.

## BALANCING COMPLIANCE AND CONVERSION

As subscription businesses scale, it becomes increasingly more important to comply with state auto-renewal regulations. At the same time, companies focused on increasing subscriptions wrestle with balancing the need for compliance with the ability to convert potential customers into subscription sales. It can be tricky, but it is essential for e-commerce businesses to strike a proper balance between compliance and conversion rates.

Fortunately, many states, such as California, have enacted a safe harbor defense for companies that attempt to comply with the provisions of the article “in good faith.” Nevertheless, given the significant penalties and potential litigation costs associated with non-compliance, companies should work with experienced professionals to maximize compliance without adversely impacting the business.

## MEET THE TEAM



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