THINKING ABOUT STARTING A SUBSCRIPTION-BASED APP OR BUSINESS? DO IT RIGHT TO AVOID LEGAL RISK

Subscription-based commerce is booming. It’s already worth an estimated $3 billion, and more and more companies, large and small, are developing or adopting subscription-based revenue models in an effort to offer convenience to consumers – and to create a continuous revenue stream for themselves and their investors. Recent success stories in this area include Dollar Shave Club (men’s shaving products), HelloFlo (feminine hygiene products), Lumosity (brain training), Office365 (Microsoft software), BarkBox (dog toys and treats), and Bulu Box (vitamins). When programs such as these involve elements of “automatic renewal,” they are required to comply with relevant state and federal statutes and regulations that companies may not be aware of.

RULES
Both federal and state rules can apply to subscription-based businesses.

The FTC’s Negative Option Rule
The “Negative Option Rule” adopted by the Federal Trade Commission (FTC) requires sellers to clearly disclose the terms of any negative option plan for the sale of goods before consumers subscribe.

The FTC uses the phrase “negative option marketing” broadly to refer to a category of commercial transactions in which sellers interpret a customer’s failure to take an affirmative action, either to reject an offer or cancel an agreement, as assent to be charged for goods or services. According to the FTC, there are four types of plans that fall into the negative option marketing category:

1) Prenotification negative option plans (e.g., sellers such as book or music clubs send periodic notices offering goods and, if consumers take no action, sellers send the goods and charge consumers);

2) Continuity plans (e.g., consumers agree in advance to receive periodic shipments of goods or provision of services, which they continue to receive until they cancel the agreement);

3) Automatic renewals (e.g., sellers automatically renew a consumer’s subscription when it expires and charge for it, unless the consumer cancels the subscription); and

THE BOTTOM LINE
Subscription-based business models are booming, and are a likely source of new businesses looking for a steady stream of income. However, if not done right, businesses could be exposed to significant legal risks. It’s critical, therefore, for businesses that offer auto renewals to review the laws and requirements with their outside counsel. Doing so can help to ensure that they adopt and follow best practices, lower the risks of litigation or regulatory action, and are ultimately successful.
4) Free-to-pay or nominal-fee-to-pay conversion offers (e.g., consumers receive goods or services for free or at a nominal fee for a trial period, after which sellers automatically begin charging a fee or higher fee unless consumers affirmatively cancel or return the goods or services).

The Federal Restore Online Shoppers Confidence Act

The Restore Online Shoppers Confidence Act (ROSCA), a federal law passed by Congress in 2010, prohibits any company or person from charging or attempting to charge any consumer for goods or services over the Internet through a negative option feature (as defined by the FTC), unless the company or person:

1) Clearly and conspicuously discloses the material terms of the transaction before obtaining billing information;

2) Obtains the consumer's express informed consent before charging the consumer; and

3) Provides “simple mechanisms” for a consumer to stop recurring charges.

In the States

Well over a dozen states – including California, Florida and New York – also regulate auto renewals and other forms of subscription-based business, including by mandating disclosure or notice, by requiring a consumer's affirmative consent before a sale can proceed, or by mandating a combination of requirements.

Regulatory Action and Litigation

The FTC has brought a number of actions under ROSCA or the Federal Trade Commission Act with respect to auto renewals. Similarly, businesses that use auto renewals frequently are finding themselves named as defendants in class action lawsuits. For instance, since California’s auto-renewal law took effect several years ago, numerous companies have been sued for allegedly violating its requirements. Just recently, for example, Blue Apron, Inc., a meal delivery service, was sued in a California court by a plaintiff who claimed damages stemming from Blue Apron’s “automatic renewal offers and continuous service offers.”

Companies that reportedly have reached settlements recently with federal or state authorities relating to automatic renewals include Angie’s List ($2.8 million), SiriusXM ($3.8 million), West Publishing and Thomson Reuters Tax Accounting ($6 million). In 2012, the FTC obtained a $359 million judgment against Jesse Willms and his companies based on their improper use of negative option marketing.

Steps to Take

Companies that offer are engaged in subscription-based business models should keep in mind five principles identified by the FTC to guide the marketing of auto renewals and online negative option offers:

1) Marketers should disclose the material terms of the offer in an understandable manner. The material terms of the offers include the existence of the offer; the offer’s total cost; the transfer of a consumer’s billing information to a third party (if applicable); and how to cancel the offer. Marketers should avoid making disclosures that are vague, unnecessarily long, or contain contradictory language.

2) Marketers should make the appearance of disclosures clear and conspicuous. To make online negative option disclosures clear and conspicuous, marketers should place them in locations on webpages where they are likely to be seen, label the disclosures (and any links to them) to indicate the importance and relevance of the information, and use text that is easy to read on the screen.
3) Marketers should disclose the offer’s material terms before consumers pay or incur a financial obligation. Marketers should disclose an offer’s material terms before consumers agree to purchase the item. Consumers often agree to an offer by clicking a “submit” button; therefore, disclosures should appear before consumers click that button.

4) Marketers should obtain consumers’ affirmative consent to the offer. Marketers should require that consumers take an affirmative step to demonstrate consent to an online negative option offer. Marketers should not rely on a pre-checked box as evidence of consent.

5) Marketers should not impede the effective operation of promised cancellation procedures. Marketers should employ cancellation procedures that allow consumers to effectively cancel negative option plans. Marketers should not engage in practices that make cancellation burdensome for consumers, such as requiring consumers to wait on hold for unreasonably long periods of time.

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