

FTC Proposes Broad-Sweeping Changes to Auto-Renew Contracts



In recent years, the Federal Trade Commission (FTC) has been much more active as it relates to franchise-related matters than it has over the last several decades. As addressed in this author's last column for Geared Up ("The Uncertain Future of Noncompetes," April 2023) it was discussed that the FTC is considering an outright ban on noncompetes for certain individuals, which may impact you as a franchise owner.

Likewise, the FTC is currently seeking comments on the franchisor-franchisee relationship regarding contract terms, relationship issues and disclosure matters (<https://www.ftc.gov/news-events/news/press-releases/2023/03/ftc-seeks-public-comment-franchisors-exerting-control-over-franchisees-workers>). Now, the FTC is focusing its attention on other matters that may affect franchise businesses, especially health clubs and spas that have customer or member agreements that automatically renew.

The term "negative option marketing" can be easily understood as a sales strategy where the seller may interpret a consumer's silence – or failure to take an affirmative action – as an acceptance of an offer for a good or service. Negative option offers generally fall into four categories:

- **Prenotification Plans** – where a seller provides a notice offering goods/services to a participating consumer and charges the consumer for the goods/services if the consumer does not decline the offer.
- **Continuity Plans** – where a consumer agrees in advance to receive periodic provision of goods/services and continues to be charged for the goods/services until the consumer cancels.
- **Automatic Renewals** – where a seller automatically renews a consumer's subscription when it expires unless the consumer cancels.
- **Free Trial Conversion Offers** – where after the free trial period, a seller automatically begins charging a fee (or higher fee) unless the consumer cancels.

Streaming-service subscriptions, such as Netflix; memberships to country clubs or community social clubs; and even professional sports teams when renewing season ticketholders' tickets – examples of negative option marketing are prevalent in many business-to-consumer arenas. Of course, health clubs and spas are no strangers to some versions of negative option marketing, especially continuity plans, automatic renewals and free trial conversion offers.

While not illegal, the use of negative option marketing has

come under increased scrutiny in recent decades as the FTC has brought numerous enforcement actions against businesses utilizing some of these practices (See, e.g., *FTC v. Vonage Holdings Corp.* (2022); *FTC v. Health Formulas, LLC* (2016); *FTC v. Complete Weightloss Center* (2008)).

The FTC's negative option rule (the "Rule"), originally effective in 1973, has constantly evolved over the years to combat the unfair and deceptive practices related to subscriptions, memberships and other recurring-payment programs. The Rule, as currently written, only applies to prenotification plans (the first of the four types of negative option marketing variances described above) and requires sellers to disclose their plan's most important terms clearly and conspicuously before consumers subscribe. Terms like how subscribers must notify the seller if they do not wish to purchase the selection, any minimum purchase obligations, the subscribers' right to cancel, the frequency with which announcements and forms will be sent, etc.

The Rule, along with a patchwork of other federal laws such as the Restore Online Shoppers' Confidence Act (ROSCA), the Telemarketing Sales Rule (TSR) and the Electronic Fund Transfer Act (EFTA), as well as some state laws (i.e., New Jersey, New York, California and Vermont) are all still lacking in terms of determent of negative option marketing, at least in the eyes of the federal government. For instance, as discussed above, the current Rule does not cover common practices such as continuity plans, automatic renewals and free trial conversions. In addition, ROSCA and the TSR do not address negative option plans in all media – ROSCA's general statutory prohibitions against deceptive negative option marketing only apply to internet sales, and the TSR's more specific provisions only apply to telemarketing. This lack of a consistent legal landscape has spurred the FTC to act.

On March 23, the FTC issued a Notice of Proposed Rulemaking (NPRM) to significantly expand legal requirements for sellers that use negative option offers. The NPRM was published in the Federal Register on April 24, and the comment deadline was



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June 23. The proposed changes in the NPRM would be applicable to all forms of negative option marketing (not just prenotification plans) in all media (e.g., telephone, internet, traditional print media and in-person transactions). Perhaps most significantly, the proposed Rule would allow the FTC to seek monetary penalties against any seller who is found to be in violation of the Rule (currently up to \$50,120 per day of non-compliance).

Several other aspects of the proposed Rule may significantly impact businesses' sales practices, as discussed below:

- **Clear and Conspicuous Disclosures:** Require businesses to disclose (1) all material information relevant to the negative option offer immediately next to the means of obtaining the consumer's consent or the negative option feature AND (2) any material term related to the underlying good or service that is necessary to prevent deception (more on this below).

- **Simple Cancellation Process (Click to Cancel):** A "click-to-cancel" process that would require a cancellation process to be as simple as the sign-up process. In addition, the cancellation must be effective immediately.

- **Consumer Consent:** Heightened consent requirements for businesses to obtain prior to making the sale from "expressed informed consent" to "unambiguously affirmative consent." Anything distracting or information not directly related to the negative option feature should be removed. This obligation to obtain consent continues for the "rest of the transaction" as well, which is unclear.

- **Annual Reminders:** Businesses must send consumers annual (at least) reminders describing the product or service, the frequency and amount of charges, and the means to cancel.

One of the main voices opposing the proposed Rule is former FTC Commissioner Christine Wilson. Wilson, who resigned from the FTC's highest position March 31, noted that the proposed Rule "would extend far beyond the negative option abuses." Wilson's main concern is that the proposed Rule would apply to misrepresentations regarding the underlying product or service, thus opening up sellers to liabilities for "product-efficacy claims ... even if the negative option terms are clearly described, informed consent is obtained and cancellation is simple."

While it is anticipated that there will be significant opposition to the broad application of the proposed Rule, it will be important for franchisees, especially those with customer agreements that may be implicated by the proposed changes, to closely monitor the progress of the changes to the Rule as the rulemaking process continues. Namely, it is imperative for franchisees to fully understand the sales practices that might fall under the proposed Rule, the membership sign-up process (where consumer consent is obtained under the proposed Rule), and the ease and simplicity of the member cancellation process.

Stay gainfully aware of rules such as this by keeping a sharp eye on proposed legislation at the federal, state and local levels so you can be readily prepared to oppose, support or implement any rules or laws that may impact your business. ⚙️

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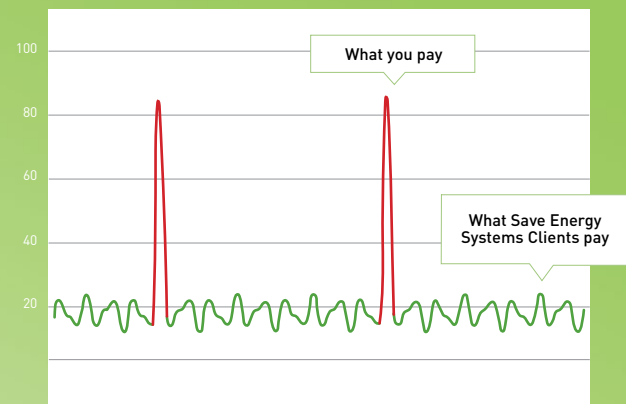
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