Evergreen Clauses

Still a Useful Commercial Contracting Tool, But Not Without Pitfalls

By John C. Muhs

Today's households increasingly rely on subscriptions in their day-to-day consumption of products and services. From video streaming and identity theft protection to prepared meals and gym memberships, subscription-based delivery models continue to rise in prominence. Similarly, businesses and their counsel are increasingly using automatic renewal provisions, or "evergreen clauses," in their contracts.

Automatic renewal provisions are common in both consumer and commercial agreements—especially in service, distribution, or supply contracts—as well as real property leases. When effective, an evergreen clause allows for an agreement to continue for a defined period if the existing agreement is not renegotiated or properly terminated within a specified time.

Consumer transactions are generally subject to certain consumer protection laws in the state in which the consumer resides (even if a contract's choice-of-law clause says otherwise). Therefore, Michigan attorneys who represent consumer-facing companies with evergreen-based revenue streams generally must consider the requirements of any state where their clients' customers live.

State laws vary widely, from placing no special limitations on the operation of automatic renewal provisions to imposing requirements on both the substantive right to automatically renew a contract and the procedure for validly exercising such right. Those regulatory efforts have seen an uptick in recent years, with many (but not all) focused on consumer contracts. Michigan law recognizes the validity of evergreen clauses, and courts generally interpret and apply them as drafted.

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Evergreen clauses and their benefits

A typical evergreen clause generally provides that the term of an agreement will automatically renew for subsequent periods of the same length unless either party provides written notice of termination to the other party within some minimum period before the current term expires. Common variations specify a renewal term that differs in length from the initial term or specify both upper and lower bounds on the notice period.

Automatic renewal provisions are attractive to businesses for a number of reasons. As a general matter, they make it easy to continue business relations without the need to renegotiate contract terms. This provides businesses with predictability that they would not otherwise have if they had to negotiate with the other party every time a contract term came close to expiring.

At a Glance

Automatic renewal provisions, or "evergreen clauses," are a common feature in consumer and commercial contracts that allow businesses to continue relationships without renegotiation.

Evergreen clauses are generally enforceable under Michigan law and remain a useful tool for conducting business within the state.

Almost half of the 50 states have enacted statutory restrictions on evergreen clauses; the substance and scope of those restrictions vary widely by state.

Of course, the party paying for the goods or services under an agreement with an evergreen clause is often unhappy to discover that it is obligated to continue paying under the contract for the remainder of the term. The drafting service provider, landlord, or seller, on the other hand, is usually comfortable with the risk of customer dissatisfaction for the benefit of a guaranteed revenue stream.

Overview of legal framework

The enforceability of an evergreen provision depends on the law of the jurisdiction that governs the contract, the nature or sophistication of the parties to the contract, and the subject matter of the contract. As will be covered further in this article, many state legislatures have enacted statutes that restrict automatic renewal provisions in some way or under certain circumstances. In other jurisdictions, courts have decided cases that address the enforceability of evergreen clauses pertaining to different transactions.

Article 2 of the Uniform Commercial Code (UCC), which governs the sale of goods in every jurisdiction except Louisiana, does not contain any express limitations on evergreen clauses. UCC § 2-309 (2002), codified in Michigan at MCL 440.2309, provides that termination by one party (except on the happening of an agreed event) requires "reasonable notification" to the other party, or enough time to seek a "substitute arrangement."[1] Thus, courts will generally enforce an automatic renewal provision in a contract for the sale of goods as long as it does not allow for notice of nonrenewal on fewer days than would allow the other party to make alternative arrangements.

Service contracts with evergreen clauses are generally governed by state common-law principles, except to the extent limited by evergreen-specific legislation in a given state. In most cases, particularly in business-to-business commercial contexts, courts strictly construe evergreen clauses when the language is clear and unambiguous.[2] If the party with the burden of providing notice fails to comply with the requirements to terminate, the contract extends for another term automatically.[3]

Of course, regulators and courts are more likely to intervene when the use of an automatic renewal provision is combined with an element of unfairness to consumers. On the

federal level, all businesses are subject to the Federal Trade Commission Act and the Restore Online Shoppers' Confidence Act (ROSCA).[4] Congress enacted ROSCA in 2011 to target unfair renewal policies; it prohibits charging internet consumers through a "negative option" provision under the terms of which consumer silence or failure to cancel a free trial is treated as acceptance of an offer for the paid service.[5] The Federal Trade Commission has consistently brought suits under ROSCA and the Federal Trade Commission Act against companies using automatic renewal policies to their gain without honest and clear disclosure.[6]

California

Relevance:
- Largest economy and most populous state
- Home to software/service providers frequently encountered by Michigan consumers and businesses

Statute:
California Business & Professional Code 17600-06
- Application: consumer subscription services
- Requirements:
  - "Clear and conspicuous" disclosure, which means larger in size or contrasting in type, font, or color than surrounding text and in close proximity to the signature line[21]
  - "Cost-effective, timely, and easy-to-use" mechanism to cancel contract, such as a toll-free telephone number or email address[22]
- Penalty: any additional services provided to the consumer are deemed an "unconditional gift"[23]

Delaware

Relevance: Frequent entity formation in the state and extensive judicial history in business matters has led to frequent application of commercial law for contracting purposes

Statute: None

Caselaw: Courts recognize validity of evergreen clauses; construe them according to their terms[24]

New York

Relevance:
- Well-developed body of commercial law
- Epicenter of banking, financial worlds

Statute:
N.Y. General Obligations Law 5-903
- Application:
  - Service, maintenance, or repair contract (consumer or commercial), or for any real or personal property; *and*
  - Automatic renewal period longer than one month
- Requirements:
  - "Clear and conspicuous" disclosure *and*
  - Notify customer 15–30 days before renewal
- Penalty: evergreen clause unenforceable

Evergreen clauses in Michigan

Other than enacting the UCC default rule on reasonable notice of termination, forays by Michigan policymakers into regulating automatic renewal provisions on consumer protection grounds have not yielded any permanent results. In the absence of a statutory or regulatory mandate, Michigan courts continue to determine the contours of the law governing automatic renewal provisions.

Michigan courts readily enforce evergreen clauses in a variety of contracts. While the Michigan Supreme Court has yet to rule on an automatic renewal provision, the Court of Appeals has enforced them or passed on their validity in business-to-business contracts, including sales agency contracts,[7] royalty agreements,[8] real estate management contracts,[9] wholesale distributorships,[10] and commercial leases.[11] Similarly in the consumer or individual-facing context, Michigan appellate courts have given effect to evergreen clauses in employment agreements,[12] auto insurance policies,[13] and certificates of deposit.[14] The U.S. Court of Appeals for the Sixth Circuit has also expressly recognized the validity of evergreen clauses as a general matter.[15] For companies whose business activities truly are limited exclusively to Michigan, the unrestricted use of evergreen clauses continues to be a viable tool in sound contracting practices.

In 2011, a bipartisan group of state legislators introduced Senate Bill 796, which would have deemed enforcing a consumer service contract containing an evergreen clause to be an "unfair, unconscionable, or deceptive" trade practice unless two conditions were met: the consumer separately signed an acknowledgement that the contract contains an automatic renewal and 30 days' advance notice of the impending renewal. The bill died in committee.[16]

Other states

Lawmakers in at least 22 states have enacted statutory restrictions on evergreen clauses.[17] Last year saw a wave of proposed legislation related to automatic renewal provisions, with more than 50 bills introduced at the state level in 2017. This article, however, is by no means a 50-state survey; the chart at left merely draws attention to the laws of a few states that Michigan-based transactional attorneys are likeliest to encounter.

Some state statutes apply to all consumer contracts regardless of the subject matter of the transaction;[18] some apply to all service contracts regardless of the nature of the parties;[19]

others are specific to certain industries, such as gym memberships.[20] A common theme in enacted legislation is a requirement that automatic renewal provisions are disclosed in a "clear and conspicuous" manner. Other provisions may require companies to make it easier to cancel or to provide advance notice before the renewal takes effect.

Best practices

Generally, to avoid having to track the varied and shifting landscape of automatic renewal laws across the country, a business could simply make automatic renewals with consumers only on a month-to-month basis. Even then, certain states require that the automatic renewal provision in the applicable contract be clear and conspicuous, while others mandate making available certain user-friendly methods of cancellation. With respect to the clear and conspicuous requirement, common practice is to use boldface, all capital letters, or both to distinguish evergreen clauses from the rest of the contract.

Given the variation in state law, it is difficult to formulate a set of meaningful principles of universal applicability. State consumer protection law often applies to any contract involving one of its residents, even if a choice of law provision says otherwise. Consumer-facing companies doing business on a national scale on uniform terms that want to minimize the risk of adverse consequences should monitor and comply with the most stringent requirements. ■

John C. Muhs is an associate in the Southfield office of Warner Norcross + Judd LLP. His practice focuses on commercial contracting and other corporate transactional matters. Muhs drafts, reviews, and negotiates various procurement, supply, distribution, and service contracts for global manufacturing businesses, automotive suppliers, energy companies, and other business clients. He also serves as outside general counsel to the North American outfit of a global tier 3 automotive supplier.

ENDNOTES

1. UCC § 2-309, official comment 8 (2002).
2. See *Eden Foods, Inc v American Soy Products, Inc*, unpublished per curiam opinion of the Michigan Court of Appeals, issued January 22, 2015 (Docket No. 318337), p 9.
3. See *Trustees of B.A.C. Local 32 Ins Fund v Fantin Enterprises, Inc*, 163 F3d 965, 968–969 (CA 6, 1998) ("When a contract is renewed via the operation of an evergreen clause, all of the attendant contractual obligations naturally continue for the period of renewal.").
4. 15 USC 41–58 and 15 USC 8401–8405.
5. 15 USC 8403.
6. See, e.g., *Fed Trade Comm v DirecTV, Inc*, unpublished order of the United States District Court for the Northern District of California, issued September 23, 2016 (Case No. 15-cv-01129-HSG).
7. *Eden Foods*, unpub op at 6–7 (finding that continued compliance with sales agency contract's provisions regarding commissions clearly indicated agreement to renew, where contract contained a provision for automatic renewal of five-year term if 90 percent of target achieved).
8. *Lighthouse Sportswear, Inc v Mich High Sch Athletic Ass'n, Inc*, unpublished per curiam opinion of the Michigan Court of Appeals, issued July 2, 2013 (Docket No. 310777), p 2 (finding no genuine issue of material fact on the question of whether the parties intended and acted with understanding that the notice deadline was July 31, where an automatic renewal provision in royalty agreement provided for both March 31 and July 31 deadlines for nonrenewal notice).
9. *Holtzman Interests 23, LLC v FFC Sugarloaf, LLC*, unpublished per curiam opinion of the Michigan Court of Appeals, issued February 14, 2012 (Docket No. 298430), p 5 (holding that nonrenewal under an automatic renewal provision with a 60-day notice requirement, unlike a termination under separate provisions for termination with or without cause, was not a "termination" for purposes of the operating agreement under which a termination triggered a purchase option).
10. *Pantall Gallup, LLC v Alnouri*, unpublished per curiam opinion of the Michigan Court of Appeals, issued November 6, 2014 (Docket No. 314852), p 1 (finding as a matter of fact that agreement renewed for an additional 10-year period under automatic renewal provision).
11. *S Grp Ltd Partnership v Adams Outdoor Advertising Co*, memorandum opinion of the Michigan Court of Appeals, issued November 25, 1997 (Docket No. 194379) (enforcing year-to-year automatic renewal provision in lease at expiration of 10-year term).
12. *Elder v Mike Dorian Ford, Inc*, unpublished per curiam opinion of the Michigan Court of Appeals, issued November 16, 2004 (Docket Nos. 244530, 244798), p 4 (rejecting argument that automatic year-to-year renewal rendered agreement to be for at-will employment).
13. *Slaughter v Smith*, 167 Mich App 400; 421 NW2d 702 (1988) (finding that insurance policy automatically renewed given the provision that required the insurer, in order not to renew, to send 20-day notice of nonrenewal, and the insurer sent notices of cancellation for nonpayment and then reinstatement instead of the required 20-day notice of nonrenewal).
14. *Trader v Comerica Bank*, 293 Mich App 210; 809 NW2d 429 (2011) (interpreting and applying money market certificate's automatic renewal provision in accordance with its terms).
15. *Trustees of B.A.C. Local 32 Ins Fund*, 163 F3d at 968, citing *Eastern Enterprises v Apfel*, 524 US 498, 511; 118 S Ct 2131; 141 L Ed 2d 451 (1998).
16. 2011 SB 796. In 2006, Michigan Attorney General Mike Cox joined the Iowa Attorney General's suit against *Time* magazine for deceptive business practices involving automatic renewal of subscriptions. Most of the 23 states who joined, including Michigan, did not and still do not have laws addressing evergreen clauses. *Time* agreed to provide clear and conspicuous disclosures to consumers concerning all of the material terms for automatic subscription renewals and to pay $4.3 million to customers and $4.5 million to the states. See State of Michigan Department of Attorney General, *Michigan Consumers Will Receive More Than $210,000 from Cox Settlement with Time Inc.* (March 21, 2006), available at <https://www.michigan.gov/documents/Time_Settlement_press_release_3-21-06_161783_7.pdf> (accessed August 8, 2018). The *Time* litigation and its settlement serve as a reminder that evergreen clauses in consumer contracts invite heightened scrutiny even in the absence of applicable prescriptive rules.
17. Arkansas, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Illinois, Louisiana, Maryland, Montana, Nevada, New Hampshire, New Mexico, New York, North Carolina, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, and Wisconsin all have some kind of statutory or regulatory restriction on evergreen contracts.
18. See, e.g., Ill Comp Stat §§ 601/10, 15, 20.
19. See, e.g., NY Gen Obligations L 5-903.
20. See, e.g., Colo Rev Stat § 6-1-704.
21. Cal Bus & Prof Code § 17601(c).
22. *Id.* at § 17602(b).
23. *Id.* at § 17603.
24. See, e.g., *DecisivEdge, LLC v VNU Grp, LLC*, unpublished opinion of the Delaware Superior Court, issued March 19, 2018 (Docket No. N17C-05-584-WCC-CCLD) (recognizing automatic renewal as valid provision) and *Standard Linen Service v Gamiel*, unpublished opinion of the Delaware Court of Common Pleas, issued May 30, 1980 (Docket No. 100-11-1979) (enforcing automatic renewal provision against party challenging existence of contract after its purported extension).