LOOKING A GIFT HORSE IN THE MOUTH

Gift Cards and Consumer Protection in Tough Economic Times

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Overview of Laws Regulating Gift Certificates and Gift Cards

Four primary types of laws on the books regulating GCs:

- Consumer Protection/Unfair and Deceptive Trade Practices Statutes
- Escheat or Abandoned Property Laws
- Banking Laws
- Privacy Laws

Taxonomy—Gift Certificates and Gift Cards

Understanding Terms: What Is a Gift Card?

- "Closed System" versus "Open System" Gift Cards
  - Who issues? "Private label" (single store) gift cards vs. bank-issued gift cards.
  - Who determines the terms and conditions printed on the card?
- Prepaid, fixed denomination, reloadable, usable at an ATM?
- Anonymous or identified by purchaser?
- How does merchant/user track value?

The card's characteristics may determine how it is regulated and whether federal or state law applies

Consumer Protection/Unfair and Deceptive Trade Practices Statutes

Federal Law

No federal law exists comprehensively regulating GCs from a consumer protection perspective, although the "Fair Gift Card Act of 2009" was introduced this session.

The US Office of the Comptroller of the Currency issued a Bulletin in August, 2006 "intended to provide guidance to national banks on disclosure and marketing issues presented by gift cards." The OCC Bulletin requires disclosure of expiration dates and fees on the card, and certain other information, such as how to obtain a replacement, how to redeem remaining balances, and how the card may be used in "split payment" transactions" accompanying the card.

Consumer Protection/Unfair and Deceptive Trade Practices Statutes

FTC Gift Card Cases

Kmart (2007) – FTC alleged that the retailer: (a) advertised its gift cards as "equivalent to cash" but failed to disclose fees assessed after two years of non-use; (b) misrepresented that the cards would never expire, and (c) used inadequate disclosures on its cards that were difficult to comprehend or wholly concealed prior to sale. Kmart agreed to update its cards to contain clear disclosures and refund dormancy fees.

Darden Restaurants (2007): FTC alleged owner of Red Lobster and other restaurants failed to adequately disclose the dormancy fees. Darden was required to disclose any automatic fee or expiration date clearly and prominently in future advertising, at point of sale and on the card, and was prohibited the company from collecting any fee on cards and restore dormancy fees that were assessed, as well as publicize the restoration program on web sites.

2008 Consumers Union Petition to FTC

In 2008, Consumers Union petitioned the FTC to protect gift cards holders when the issuing retailers file for bankruptcy. Consumers Union called on the FTC to declare the sale of gift cards without segregating funds and holding the funds in trust to be an unfair and deceptive practice. Consumers Union also urged FTC to:

- Intervene in bankruptcy proceedings;
- Develop a registry of bankrupt retailers' gift-card practices;
- Require retailers to:

  (1) Report to the registry within one day of filing for bankruptcy;

  (2) stop selling gift cards the date of the bankruptcy filing;

  (3) inform third party vendors to stop selling any bankrupt retailers' gift cards; and

  (4) Require third party vendors to immediately cease sale of bankrupt retailers' gift cards.

Senate Bill 710 (Proposed New Law)

- Senators Schumer and Udall introduced Bill on March 25, 2009.
- Introduced as an amendment to a major credit-card reform bill.
- Passed the Senate Banking Committee by a very narrow margin, and is now up for a Senate vote.
- Bill would amend the FTC Act to incorporate many of the more stringent restrictions now imposed by state laws.

Senate Bill 710, con't

- Dormancy, inactivity, and service fees are prohibited unless: (1) there is less than $5 remaining; (2) on a rechargeable card; (3) the fee does not exceed $1; (4) the card has been inactive for 24 months after purchase; and (5) the fee was disclosed in accordance with certain disclosure requirements at the time of purchase.

- Expiration dates are prohibited unless: (1) the date is no less than 5 years after the date of purchase; and (2) the terms of expiration are prominently disclosed in all capital letters and at least 10-point type.

Senate Bill 710, con't

- *Coverage:* The Bill's restrictions on fees and expiration dates apply to not only gift certificates and store gift cards, but also to bank-issued general-use prepaid cards.

- *Exceptions*: (1) Gift certificates distributed as part of a loyalty, award, or promotional program, that cannot be exchanged for money; or (2) Gift certificates that expire within 30 days after they are sold, and are sold below the face value of the certificate for fund-raising purposes.

State Law -- Expiration Dates

Much recent state legislative activity relating to GCs has focused on the permissibility of imposing expiration dates and fees.

States have taken a variety of approaches to the imposition of expiration Dates:

- Growing trend – prohibit expiration dates altogether. *E.g.*, CA, CT, FL, IL (2008), ME, MN, MT, NH, NJ (2008), RI, and WA.
- Permit expiration dates, but require clear disclosure and/or that GC must be valid for a minimum number of years. *E.g.*, AR (2 years), KS (5 years), KY (1 year), MA (7 years), MI (5 years) (2008), ND (6 years), NM (5 years), OH (2 years), OK (5 years), and TN (2 years).
- Require clear and conspicuous disclosure of expiration date on GC, or permit issuer to provide a phone number or web address where information can be obtained. *E.g.*, NV, OR, VA, IL, UT.
- Provide that GCs will be subject to state escheat laws only if the GC has an expiration date. *E.g.* HI (2008), NE (2008), PA.

State Law -- Fees

The question of whether a GC issuer may charge dormancy and/or service fees on GCs after a certain period of time has passed is also being hotly debated today, and variation in state law reflects this debate.

State approaches to the imposition of fees:

- Prohibit fees. *E.g.*, CT, FL, HI, IL, LA (except $1 handling fee), MA (if they reduce the value of the GC)(2008), MN , MT, NH, ND, NJ, NM, OR, RI, and VT.
- Allow fees but require that they be clearly disclosed.
- Allow fees under very particular circumstances, or when a certain time period has elapsed.
  - *E.g.*, CA permits fees only when remaining value is $5 or less, fee is not more than $1 per month, GC is inactive for 24 months, and GC is reloadable.

Consumer Protection/Unfair and Deceptive Trade Practices Statutes

Misc. Issues

- *Date of Issue*. A few states require that the date of issuance for GC must be printed on the card.
- *Toll-Free Numbers*. Some states require or allow GC issuers to disclose a toll-free number that holders may call to find out balance, expiration date and other terms and conditions.
- *Forms of Redemption*. Some states regulate how a GC may be redeemed. The most common requirement is a cash redemption requirement, e.g., unused de minimis portions of the GC must be redeemable in cash. In CA, GCs sold after 1997 must be redeemable in cash for their full value. In 2008, Maine and Massachusetts passed new laws requiring that certain remaining balances be redeemable in cash to the GC holder.
- *Common Exemptions from State Laws.* Many states have exempted several types of GCs from their consumer protection statutes:
  - GCs issued for use with multiple sellers. *E.g.,* CA, IL, LA, MD, MT, NV, ND. *But see* NY.
  - GCs issued under customer loyalty programs. E.g. AZ, AR, CA, FL, GA, HI (expiration date must appear on GC or receipt), IL, LA, MD, MA, MT, NV, NH, NJ, NM, ND, OH, OK, RI, TN, TX, VT, WA. In some states, GCs issued under consumer loyalty programs are arguably exempt because they are not *purchased.*
  - GCs issued below face value for fundraising purposes. *E.g.,* AZ, CA, HI, IL, LA, NV, NY, OK, TX, VT, WA.

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Recent and Pending State Legislation

1. **Alaska.** *Pending* H.B. 64 makes the violation of certain gift card prohibitions an unlawful trade practice.
2. **Florida.** New legislation clarifies that restrictions on gift cards only apply to *purchased instruments*.
3. **Indiana.** *Pending* HB 1529, 1122 would prohibit companies from charging maintenance fees or imposing expiration dates. *Passed House, to Senate.*
4. **Massachusetts.** New $300 fine for imposing gift card fees that reduce the value of the gift card, or any fee that is not clearly disclosed. The holders of gift cards must be able to receive the remaining 10% or $5 of value on a gift card in cash, depending on whether the card permits the addition of value.
5. **Michigan.** New law H 4680 prohibits gift cards from having expiration periods of less than 5 years.

Recent Developments in Gift Card Law

Recent and Pending State Legislation, cont'd.

7. Missouri. *Pending* H 198 would prohibit expiration dates earlier than 5 years after the date of issuance, and all post-purchase fees on gift certificates.
8. New Jersey. NJ A 3495, filed Nov. 2008, provides that gift certificates, prepaid bank cards and gift cards shall not expire or contain dormancy fees. *Pending* S 2509 would prohibit expiration dates or dormancy fees on gift certificates, gift cards, or prepaid bank cards. *Pending* S.B. 566 would make it unlawful to sell gift cards unless they are packaged to prevent persons from viewing the gift card account number prior to purchase (Assembly version of this bill passed). *Pending* A.B. 2363 makes it unlawful to sell preloaded gift cards via internet auction.
9. New York. *Pending* A.B. 1541 would require retailers issuing gift cards to hold the amount equal to the issued gift certificate in escrow to be paid out upon closing of the retailer.
10. Virginia. *Pending* H.B. 329 would require any gift certificate that is charged a fee or fees, or has an expiration date, to include a telephone number or internet address where the holder can obtain information regarding such fees or expiration date. *Pending* H.B. 859 prohibits charging fees for the first 12 months after issuance, or issue a gift certificate that automatically expires, diminishes in value, or otherwise become unredeemable within the first 24 months after issuance.

Enforcement Trends – New York

1. NY state law requires that the terms and conditions for gift cards must be displayed in advertising, direct mail, and in retail stores (on placards or signs) where the gift cards are sold.
2. NYS GBL § 396-I includes a provision requiring placards or signs at retail locations which is being actively enforced by the City of NY.
3. NY Attorney General Report on Gift Cards (Dec., 2008):

   (A) Cites NY OAG actions against, and settlements with, large retailers of gift cards, and

   (B) NY OAG intervention in bankruptcy proceedings to protect the rights of gift-card purchasers.

Recent Developments in Gift Card Law

NY AG Report on Gift Cards (12/2008):

1. **Consumer Protection Disclosures.** The Report warned consumers about the "dangers" of gift cards, addressing many of the consumer protection concerns that are common in the gift card "space," such as expiration dates hidden fees that serve to de facto expire the card and addressed their proper disclosure, as well as how to handle split payment transactions and the refund of de minimis balances.
2. **Replace Lost/Stolen/Defective Cards**: The Report also discusses a series of retailer settlements in 2003 and 2004 involving lost/stolen/defective gift cards: in 2003-2004, the AG signed a consent order with 18 retailers, including Home Depot, Best Buy, Disney, J.C. Penney, Kohl's, Nordstrom, Sears, Target, and Sports Authority after it determined that the retailers did not have adequate procedures and mechanisms in place to replace lost, stolen and defective gift cards. The retailers agreed to reissue lost or stolen gift cards upon the consumers' showing reasonable proof of ownership, such as a receipt of a credit card "transaction register." According to Cuomo, "[i]t is a deceptive practice to claim that lost, stolen or damaged gift cards cannot be replaced in situations where the retailer has the information necessary to make replacement possible."
3. **Intervention in Retailer Bankruptcy Proceedings:** The NY AG has also intervened a number of times in bankruptcy proceedings to protect the rights of gift-card purchasers.

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CURRENT ISSUES

Recent Court Cases

1. **The Simon Property Group Cases.** Simon's bank-issued gift cards are subject to monthly administrative and non-use fees that decrease the value of the cards over time. Courts are split as to whether the cards are subject to state consumer protection and unclaimed property laws.
2. **Skype/eBay.** Class action filed alleging violations of WA gift card rules. Plaintiff argues that Skype's "stored value accounts" constitute gift cards under WA law, and thus Skype cannot impose an expiration date and claim the balance of such accounts if they are unused after 180 days/the expiration policy is an unlawful dormancy or inactivity charge.

Recent Court Cases (cont'd)

3. **Shell Oil.** Private plaintiff's deceptive practices and common law claims based on insufficient disclosure of "dormancy fees" were not barred by NY State gift card statute.
4. **Also** under NY law (GBL § 396-i), small print disclosures of "dormancy fees" on Simon Gift Cards could violate that state's gift card statute, which contains a specific 10 point font size requirement.
5. **Kennedy v. Schwan's Home Service.** Under a statutory exception, CA ban on expiration dates does not apply to gift certificates "issued for a food product" where the expiration is clearly printed on the front of the certificate in capital letters.

CURRENT ISSUES

Cortney Reynolds v. Philip Morris USA Inc. (S.D. Cal., Civ. No. 05-CV-1876), (to be argued 4/17/09 in the US Court of Appeals for the Ninth Circuit), is an important case addressing the issue of whether promotional incentives are gift certificates under CA law.

- CA prohibits the use of expiration dates on “gift certificates” (leaving the term undefined), but it exempts certain GCs issued on or after Jan. 1998 and distributed by the issuer to consumers without charge under an awards, loyalty or promotional program, provided that they contain: (1) an expiration date, (2) in capital letters, (3) in at least 10-pt. type, (4) on the card’s front.
- In 2007, the lower court determined that "Marlboro Miles," proofs of purchase that may be redeemed for items from a catalogue, are valid "gift certificates" that do not bear expiration dates and are therefore redeemable forever under CA law.
- In its appeal, Marlboro has raised the point that the lower court's finding with regard to the "Marlboro Miles" program could adversely affect many other programs. Cereal box top, bottle cap, and credit card point programs would all have to have an expiration date in the font size required by the California statute, or else be valid forever.

State Escheat Law

- Escheat law provides that property may be presumed abandoned if there is no activity with respect to the property for a specified period of time. The abandoned property must be turned over to the state pursuant to the state's reporting system.
- What typically constitutes abandoned property? Examples: Uncashed payroll checks, deposits, refunds to consumers, dividends, etc.
- Important issue – penalties and interest for failure to escheat can be significant

State Escheat Law

States have reached different conclusions on the issue of whether unused GCs are abandoned property that escheats to the state:

– **Majority Approach:** Unused GCs are abandoned property that will escheat.

– **Minority Approaches:**

  - Exclusion of GCs from abandoned property laws.
  - Legislation deleting references to "gift certificates" from the unclaimed property provisions.
  - Exemptions for specifically defined types of GCs.
  - Linking of unclaimed property issue and expiration date/fee issue – exempt GCs without expiration dates, or those where expiration is not enforced, or where no fees. E.g., **Hawaii.** Effective July 1, 2009, 100% of the value of a gift card is presumed abandoned after 5 years, but the abandonment provision *does not* apply to gift cards without enforced expiration dates or fees.

An increasing number of states are moving to exclude or exempt GCs from the escheat laws

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State Escheat Law

Complex rules of priority in escheat determine which state will get tangible and intangible property that goes unclaimed.

Federal Common Law Rules: The Supreme Court has outlined two rules that outline the rights of states, *vis-à-vis* one another, to escheat tangible property.

- The primary right to escheat belongs to the state of the "creditor's" last known address (i.e. state of the owner of the abandoned property).
- If the primary rule fails (e.g., if the last known address of the GC purchaser is not known), the right to escheat devolves to the state in which the debtor is incorporated.

Transaction-Based Test (TBT): In some states, there is a third rule of priority that looks to the state where the transaction occurred to determine where unclaimed property will escheat.

**In states that have the TBT, but do not exempt GCs from escheat, even companies that have incorporated in states that have exempted GCs (a common escheat avoidance strategy) may end up with significant abandoned property liability.*

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Banking Laws

Why Do Banking Laws Apply to GCs?

Because of the deposit-based nature of gift cards, the merchant may be deemed to be a “bank” or “financial institution” under some state and federal laws, even if it is not a traditional bank.

Moreover, because many cards are reloadable, the federal government is concerned that the cards may be used for money-laundering purposes.

The law in this area is very much in flux. The FDIC is currently looking at the issue of whether funds at banks underlying stored value card accounts must be insured, and the federal government and states do not always agree on all of the issues.

Federal Banking Laws

Bank Secrecy Act/Anti-Money Laundering/OFAC. GC providers should take into account the regulations of the Office of Foreign Assets Control (OFAC) prohibiting any U.S. person from conducting transactions with certain entities and persons listed on OFAC's specially designated and blocked persons list.

- GC providers should consider risk-based internal controls to screen private information against the OFAC list to avoid liability.
- GC issuers may be required to report suspicious activity, and to have policies/procedures in place to comply with the duty to file
  (1) Reports of currency transactions in excess of $10,000 per day;
  (2) Reports of international transportation of foreign currency/monetary instruments; and
  (3) Reports of foreign bank and financial accounts.

USA PATRIOT Act. The Act requires all "financial institutions" to establish and maintain a customer identification program to ensure that the person whom the institution is accepting as a customer is who they say they are. Issuers of disposable, fixed denomination gift cards are not currently required to comply, but open system reloadable prepaid cards must require customer identification.

Banking Laws

State Money Transmitter Laws

These laws govern entities that issue checks, travelers' checks, money orders and electronic equivalents.

Most states have money transmitter laws, but only a small number have affirmatively taken the position that gift card issuers are in fact money transmitters.

The money transmitter laws usually require licensure and payment of fees, may require a surety bond or minimum capitalization, and impose reporting obligations and require periodic state audits.

Banking Laws

Other Practices to Avoid

- Advertising a GC as having “no expiration date” if fees may consume the card and have the same effect as an expiration date, or other practices that might violate OCC guidance.

- Describing products in terms suggesting that they are similar to other (bank-issued) payment instruments with which customers are more familiar.

- Describing GC products that carry federal deposit insurance when such insurance does not apply.

Marketing partners using bank-issued GCs should also avoid these practices, lest they be charged with joint and several liability.

Privacy Laws

The purchase of a GC may require the collection of consumer personal information that will implicate consumer privacy concerns under federal and state law.

Gift card issuers may qualify as “financial institutions” under federal and state laws regulating the ability of a financial institution to use and distribute a consumer’s personal information.

Applicable privacy obligations may include: (1) self-imposed restrictions, such as an internet privacy policy; (2) statutory obligations governing online data collection and offline data practices; and/or (3) state data security breach notification laws.

What Are Some of the Applicable Laws?

Unless collecting personal information through the Internet from a CA resident, there is no general privacy law requiring Web sites to post a privacy policy. But, most Web sites voluntarily post a privacy policy, which subjects them to liability for violation of federal and state laws against deceptive practices. Typically applicable:

- *Section 5 of the FTC Act* -- A company defines the information to which Section 5 applies by the scope of the company's own representations in its privacy policy.
- *California Online Privacy Protection Act* -- has become a *de facto* national standard to the extent that Web sites anticipate collecting data from California residents.
- *Gramm-Leach Bliley Act* -- At a minimum, gift card issuers should be aware of GLBA requirements, should have a privacy policy and provide it to purchasers of their cards and provide proper opt-out procedures. To the extent that a gift card issuer is providing a product that truly "acts like a bank card," the issuer should be prepared to comply..
- FACTA/FCRA and the "Red Flags Rule" – Again, whether GC issuers are covered depends on whether they meet a narrow definition of covered institutions, generally, those using "consumer reports" for various purposes.

Conclusion

What's on the horizon?

- Federal law restricting terms and conditions for both store-issued and bank-issued gift cards.
- Creative new uses in rebates, customer loyalty, payroll, FSA – leading to heightened interest by regulators and legislators.
- More of the same in terms of new consumer protection and escheat laws:
- Need to lobby for more exemptions from escheat laws as antidote for third priority rule states?

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