

## THE NEW LOOK OF GIFT CARDS

### Gift Cards and Promotions in the New Millennium

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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 Laws

### Federal Credit Card Accountability Responsibility & Disclosure Act of 2009 (“CARD Act”)

Amends Electronic Funds Transfer Act; signed into law on 5/22/2009, Fed regs implemented as of 1/31/2011.

#### **Key Provisions:**

- **Expiration Dates:** Card or certificate may not expire earlier than five years after the date on which it was issued. The terms of any expiration date must be clearly and conspicuously stated.
- **Fee Limitations:** The Act prohibits dormancy,, inactivity, or service fees on certificates or cards unless:
  - there has been no activity on the certificate or card for 12 months;
  - required disclosures have been made (that fee may be charged for inactivity, amount and frequency of fee) ;
  - only one fee is charged per month; and
  - additional requirements determined by the Board of Federal Reserve System (the “Board”) are met.
- **Scope:** Act applies broadly to gift cards, stored value cards, and general use prepaid cards. Nonetheless, the Act contains a number of important exclusions, including:
  - loyalty, award or promotional gift cards;
  - gift cards used solely for telephone services;
  - gift cards that are reloadable and are not marketed or labeled as a gift card or gift certificate;
  - gift cards that are not marketed to the general public;
  - gift cards that are redeemable only for admission to events or venues at particular locations;
  - gift certificates that are issued only in paper form.

### Federal Trade Commission Actions Involving Gift Cards

- ***Kmart (2007):*** FTC alleged that the Kmart: (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 from collecting any fee on cards and required to restore dormancy fees that were assessed, as well as publicize the restoration program on web sites.

## Consumer Protection/Unfair and Deceptive Trade Practices Laws

### Federal Law: 2008 Consumers Union Petition to FTC

In 2008, Consumers Union petitioned the FTC to protect gift card holders when the issuing retailers file for bankruptcy, calling on the FTC to declare the sale of gift cards without segregating and holding 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 upon filing;
  - (3) Inform third parties to stop selling bankrupt retailers' cards; and
  - (4) Require third party vendors to immediately cease sale of gift cards.

➤ *The FTC conveyed that it would continue to seek additional factual and legal information on the issues raised by Consumers Union; NY AG's Office has been active on issue as well.*

# Consumer Protection/Unfair and Deceptive Trade Practices Laws

## 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, ME, MN, MT, NH, NJ, 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), 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.*, NY, NV, VA, IL, UT.
- Provide that GCs will be subject to state escheat laws only if the GC has an expiration date. *E.g.* HI, NE, PA.

# Consumer Protection/Unfair and Deceptive Trade Practices Laws

## 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.*, CO (2010), CT, FL, HI, IL, LA (except \$1 handling fee), MA (if they reduce the value of the GC), 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 Laws

## 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 certain 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*. *E.g.*, CT, MI.
  - GCs issued below face value for fundraising purposes. *E.g.*, AZ, CA, HI, IL, LA, NV, NY, OK, TX, VT, WA.
  - Prepaid telephone cards. *E.g.*, CA, NJ.

## Recent Developments in Gift Card Law

### Recent State Legislation

- **Utah:** SB 270, effective July 1, 2011. Defines the term “gift card” and exempts from the Unclaimed Property Act a gift card, gift certificate, or credit memo.
- **New York:** A.B. 11007, effective January 1, 2011. Requires businesses advertising or offering consumer rebates to conspicuously disclose, including in advertising, if the rebates will be issued in the form of a gift certificate or gift card and whether any additional fees related to the use or non-use of the rebate may apply.
- **Colorado:** SB 10-115, effective August 11, 2010. Requires gift card issuers to redeem the card, upon request, if the remaining value is \$5 or less. In addition, it bans retailers, restaurants and others from selling gift cards that have any type of fee, including a service fee, a dormancy fee, an inactivity fee or a maintenance fee. Applies only to gift cards issued on or after the effective date.

## Recent Developments in Gift Card Law

### Enforcement Trends – New York

1. NYS GBL § 396-I requires that disclosures that “terms and conditions apply to gift cards” be included in advertising, and displayed in retail stores (on placards or signs at the POS) where gift cards are sold-being actively enforced.
2. **NY Office of Attorney General Report on Gift Cards** (Dec. 2008):
  - a) **Consumer Protection Disclosures.** Report warned consumers about the “dangers” of gift cards, e.g., expiration dates and hidden fees, and addressed proper disclosure, how to handle split payment transactions, de minimis balances.
  - b) **Replace Lost/Stolen/Defective Cards:** Report discusses a series of settlements in 2003/2004 involving lost/stolen/defective gift cards in which OAG determined retailers did not have adequate procedures and mechanisms in place to replace lost, stolen and defective gift cards. Retailers agreed to reissue cards upon showing reasonable proof of ownership, such as a receipt or a credit card “transaction register.”
    - 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.”
  - c) **Intervention in Retailer Bankruptcy Proceedings:** AG also intervened in a several bankruptcy proceedings to protect the rights of gift-card purchasers.

## 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 or federal laws.
2. **Skype/eBay.** Class action filed alleging violations of WA gift card rules. Plaintiff argued 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. Settled in January 2010 for over \$1.85 million.

## CURRENT ISSUES

### Recent Court Cases (cont'd)

3. **Llanos v. 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; private right of action for deceptive marketing of gift card subject to monthly dormancy fee after 12 months was permitted.
4. **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.

### Recent Court Cases (cont'd)

5. **Groupon settlement.** Groupon sued under IL gift card law prohibiting expiration period of shorter than 5 years when third parties selling on site expired groupons more quickly. Company has put in writing that it will refund amount paid where third-party merchant refuses to honor gift certificate during period required by statute; had alleged already did this (see *also Restaurant.com* case, dismissed by D.N.J. for failure to state a claim due to lack of economic loss).
6. **Cortney Reynolds v. Philip Morris USA.** Ninth Circuit held that the CA gift card law did not apply to the “Marlboro Miles” reward program.

## 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 laws.
  - Exemptions for specifically defined types of GCs, e.g., GCs for merchandise and services, or for promotional, loyalty and rewards programs or charitable undertakings.
  - Linking of unclaimed property issue and expiration dates/fees – exempt GCs without expiration dates, those where expiration is not enforced, or where no fees. *E.g., HI: eff. 7/1/2009, 100% of the value of GC is presumed abandoned after 5 years, but abandonment provision does not apply to GCs without enforced expiration dates or fees; see also TN, TX.*

*An increasing number of states are moving to exclude/exempt GCs from escheat laws*

# State Escheat Law

## Abandoned Property Priority Rules

**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):** Certain states have adopted a third priority rule, codified in the Uniform Unclaimed Property Act, 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.
- The TBT is NOT uniformly accepted; indeed, it was recently rejected by the US District Court for the District of New Jersey as preempted by the Supreme Court’s priority rules.

## State Escheat Law

### **New Jersey Gift Card Law**

- Effective July 1, 2010, new NJ law prohibits dormancy fees, and provides for an abandonment period of only two years (in conflict with CARD Act 5 year minimum expiration).
- Broad definition of “stored value cards” to include unclaimed gift certificates, gift card balances, and rebate cards for the purposes of escheat to the state.
- Requires stored value card issuers to obtain a name/address for purchaser or owner of every stored value card sold, if issuer sells gift cards worth an aggregate of over \$250,000 a year.
  - If do not have name/address, presumption is purchased in-state and gift card will escheat to NJ.
  - Subsequent interpretive guidance issued by NJ Treasury states that issuers must collect, at a minimum, the zip code of purchaser.
- Litigation quickly filed challenging the law by American Express, New Jersey Retail Merchants Association, and New Jersey Food Council.
  - Argues statute is preempted, unconstitutional, violates contracts clause.
  - Preliminary injunction initially entered against POP presumption; data collection requirements suspended indefinitely after Third Circuit’s January 31st entry of a temporary restraining order.

## 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.



# Banking Laws

## 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.

### **Proposed FinCEN Regulations Affecting Sellers of Prepaid Cards**

The U.S. Department of the Treasury, Financial Crimes Enforcement Network (FinCEN) proposed rules in June 2010 that would require certain "non-bank providers" of prepaid access products to:

- collect identifying information when selling prepaid cards;
- retain the information for five years;
- maintain certain anti-money laundering programs;
- track transaction data and report suspicious activity; and
- register with FinCEN.

Rule is meant to curtail money laundering activities and would include certain exceptions – for example, for cards that cannot exceed \$1,000 in value and are marked accordingly, or cards that can only be used at one store.

Regulation has not yet been implemented - a timetable for implementation has not yet been issued, but final determination is anticipated in 2011.

## 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.

- Ex. NJ zip code requirement vs. *Pineda v. Williams-Sonoma*, CA Song-Beverly card case just decided

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.



## Privacy 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?*

- 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?



Questions?



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