



Loyalty Programs

Venable Advertising Law Webinars

May 28th, 2020

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Introduction

- Loyalty programs are *hugely popular*. According to an article published this month in Forbes magazine, more than 3.3 billion people participate in loyalty programs, and more than 90% of companies have a program.
- Loyalty programs may implicate multiple areas of law:
 - Contract
 - UDAP/Consumer Protection
 - Fraud
 - Tax/Unclaimed Property
 - Money Transmission
 - Sweepstakes and Contests/Charitable Promotions
 - Internet/Social Media
 - Privacy and Data Security
 - CAN-SPAM/TCPA
 - Antitrust
 - Labor and Employment Law
 - Franchise



Drafting Terms & Conditions for Loyalty Programs

The program terms are a contract: It's crucial to have comprehensive terms and conditions.

Right to modify/termination clause: The right to modify and/or terminate the terms and conditions is crucial. Significant litigation has focused on attempts to modify/terminate and courts are often deferential:

- ***Monzingo v. Alaska Air Grp., Inc.***, 112 P.3d 655 (Alaska 2005); ***Grossman v. USAir, Inc.***, 33 Phila. Co. Rptr. 427 (Ct. Com. Pl. 1997): Airlines allowed to increase the number of miles required for rewards where there was clear reservation of rights in program terms.
- ***Han v. United Continental Holdings, Inc.***, 762 F.3d 598 (7th Cir. 2014): Court held that term giving interpretive discretion to United meant plaintiff must prove interpretation was unreasonable as a matter of law, affirming trial court's dismissal.
- ***Lagen v. United Continental Holdings, Inc.***, 774 F.3d 1124 (7th Cir. 2014): Court upheld the airlines' right to change or eliminate frequent flyer program benefits.

COVID-19 has had us going back to the terms again: force majeure, right to postpone, substitute, pull rewards.

Notice of Changes/Modification

What kind of notice is required when making changes?

- Program terms should have a notice provision that defines: (1) **how** notice of changes will be provided; (2) how **much** notice will be provided; and (3) how members will **accept changes**.
 - Many loyalty programs provide for little or no notice (0 to 60 days).
 - Stating “Company will provide notice of changes” without defining method of notice (e.g., posting on website, email) is too vague/may result in liability.
 - Acceptance: Best practice may vary based on type of term.
- Notice has become a key issue in recent litigation.
 - *See, e.g., Hughes v. AutoZone Parts Inc.*, Case No. BC631080 (Sup. Ct. Cal. 2016).
 - Be particularly careful if the effect of the change is to eliminate earned rewards.
- Follow your procedures!

Notice of Changes/Cancellation: Best Practices

- **Notice should be clear and concise.**
 - Explain the change.
 - When it takes effect.
- **Change should not impact redemptions prior to the change date.**
- **Timing of notice** (not specified by law):
 - Should not be too far out (consumers forget), or too close to the change date (not enough time).
 - Consider multiple notices – 60 days out, 30 days out, 14 days out, 7 days out.
 - Notice provided directly (by email or mail), or posting online.
- **Good idea to give advance notice of any change that:**
 - Impacts the value of the member's points.
 - Changes the member's ability to earn or use points.
 - Cancels/terminates the program.
 - Converts the points to a different program.

UDAP/Consumer Protection Laws

- Federal and state laws prohibit merchants from engaging in unfair and deceptive trade practices, e.g.:
 - Promoting a loyalty program in a false and misleading manner.
 - Failing to disclose material terms clearly and conspicuously.
 - Failing to meet reasonable consumer expectations and assumptions.
- *Watch for conflicts between advertising and terms.*
- Traditionally, courts examining loyalty programs have relied on the program terms to dismiss lawsuits, giving little weight to consumer protection claims.
 - But see ***Gao v. JP Morgan Chase & Co.***, Case No. 1:14-cv-4281 (S.D.N.Y. Sept. 12, 2017): Court found promise in advertising that “points never expire” could be deceptive.
- Several state attorneys general have filed cases against large drugstore chains alleging that their programs were deceptive.
 - See, e.g., **NY Attorney General Settlement with Walgreens/Duane Reade (2016); Missouri Attorney General Lawsuit against Walgreens (2013); Florida AG settlement with CVS (2007).**

Accumulation and Application of Points

- Disclose your rules and then follow them.
- *E.g.*, if loyalty points generate coupons or discounts at checkout, then they must be applied consistently and in conformity with program terms and advertising.
 - If purchases generate loyalty points, customers must receive the full amount promised by program terms.
 - Companies must apply discounts as promised, disclose any exceptions, and follow loyalty program requirements.
- Potential “tender points”: coupons, advertised discounts, returns, “*same as cash.*”
 - ***Neil Torczyner v. Staples Inc.***, Case No. 3:16-cv-02965, (S.D. Cal. 2016), : misapplication of coupon in returns/refunds.
 - ***Waters v. Kohl’s Department Stores***, Case No. 2:17-cv-02325(C.D. Cal. 2017): is “Kohl’s cash” the “same as cash” if it is applied before discounts in a transaction?

Fraud

- **Fraud can be a big problem with loyalty programs:**
 - Consumer fraud—owner of account violates terms of service to illegitimately accumulate points.
 - Internal fraud—employees and insiders.
 - External fraud—hacking, identity theft.
- **How to limit risk?**
 - **Robust and clear rules:** Carefully craft rules to prevent unintended point schemes, detect illegitimate uses, and preserve right to fully enforce all program rules.
 - **Educate program members:** Incentivize members to use strong passwords, periodically change their passwords, and monitor their account activity.
 - **Intrusion protection:** Implement industry standard cybersecurity protocols and intrusion detection to prevent and alert the system manager of any breaches.
 - **Enhanced internal controls and monitoring:** Includes enhanced vetting of program administrators and employees, restricting access of internal controls to a “need-to-access” basis, and monitoring the system for irregularities.

Money Transmission/AML

- Bank Secrecy Act/anti-money laundering laws: define money transmission as receipt and/or transmission of currency/funds or their value to another person or location.
 - A “currency” includes “convertible virtual currencies” that have an equivalent value in or serve as a replacement for real currency.
- Consider:
 - Can points be purchased or redeemed for cash?
 - Is there a secondary market for points or credits?
 - Can members transfer points or credits to each other?
- If the answer to any of these questions is yes, there is a risk that money transmission laws may apply.
- Unclaimed property laws have started to include provisions addressing currency as well, *e.g.*, Utah, Delaware bills.



Tax

- S&H Green Stamps Rule
- 26 C.F.R. 1.451-4 and the Accrual Method: Allows accrual-method taxpayers to subtract from gross receipts an amount equal to:
 - The cost of redemptions in the tax year and
 - Estimated future redemptions.
 - Therefore allows an accelerated recognition of redemption costs.
- Must meet certain requirements.
 - “With sales” requirement – points awarded when making a purchase.
 - “Redeemable” requirement – points must be redeemable for cash, merchandise, or other property.
- Most retailer customer loyalty programs qualify under the regulation ... but not all. (Rev. Rul. 78-212)

Unclaimed Property

- State unclaimed property laws, rooted in common law “escheat,” provide that property may be presumed abandoned under state law if there is no activity with respect to the property for a specified period.
- In recent years, state regulators have been increasingly aggressive in seeking to collect abandoned property.
 - September 2018: An online retailer found guilty after jury trial in a reverse False Claims Act case for concealing nearly \$3 million in unpaid escheat claims. *See State of Delaware ex. rel. William Sean French v. Card Compliant, LLC* (C.A. No. N13C-06-289 Del. Sup. Ct. 2018).
- Unclear whether loyalty programs generally will be treated as property subject to the unclaimed property laws.
- Laws vary significantly by state. Some specifically exempt “merchandise points” (see Ariz. Rev. Stat. § 44-301(15) and N.C. Gen. Stat. Ann. § 116B-54), while others have created exceptions for “loyalty cards” (see Del. Code Ann. tit. 12, § 1130 and Illinois, 765 Ill. Comp. Stat. Ann. 1026/15-102).



Sweepstakes and Contests

- Increasingly common to link prize promotions to loyalty programs as a way to win or redeem points.
- **Possible lottery/gambling issue:** if rewards points are required to “buy” entries, is that consideration? Do you need to offer a free Alternative Method of Entry (“AMOE”)?
 - Do points even have value?
 - Must spend/buy things to earn points.
 - Points are often treated as being without value for tax and other purposes.
 - What if you can redeem points for gift cards with cash value?
 - What about auctions in which members can bid with points? What if you have a “buy it now” bid price for items being offered?
- ***Best practice is simply to offer a free AMOE to ensure there is no consideration issue.***

Charitable Promotions/Commercial Coventures

Many programs now offer the ability to donate points to charitable partners. What are the legal and practical issues?

- Commercial coventures (“CCVs”) with charities may trigger registration and bonding requirements, along with specific advertising, accounting, and agreement requirements.
- If there is no “purchase” (“free action”), then the CCV laws may not be triggered.
- Still, do your charity partner due diligence: Are specific charities identified? Or can customers choose their own charity?
 - Is the charity partner registered to conduct fundraising?
 - Has an agreement been negotiated with the charity?
 - Does the agreement include a trademark license?
 - Have specific donation triggers/dates been set? What if they are not met? What if they are exceeded? Will an accounting be provided, and when?

Experiences and Buzz Activations

- Buzz or experiential activations = cross-platform activations that may have both (a) on-the-ground and (b) social components, e.g., a festival, party, launch, e.g., W
- Intellectual property/third-party issues:
 - Right of publicity: e.g., people talking about product, people participating in activation, third parties in background...
 - Trademark/copyright: e.g., music in background, store signs, artwork
 - Landlord/owner rights
- Crowd control/safety
- Employee/staff (contractor) training
- How to enforce eligibility requirements—residency, age, etc.
- Local licensing considerations
- Partnering concerns—e.g., festival co-sponsors
- Other issues, e.g., influencers, loyalty programs, live streaming
- A badly planned activation can result in litigation—plan ahead!



Social Media and the FTC's Endorsements and Testimonials Rule

- Basic principle: **Material connections** that might affect credibility must be disclosed, e.g., payment or other compensation; employment, business, or family connections.
 - Loyalty points are "other compensation" (also sweepstakes entries)
- FTC has been very active in enforcing the Guide, providing guidance as to how influencers should and should not disclose.
 - *E.g.*, #Ad, "Thanks for all the Bonvoy points and the great vacation, Marriott!"
 - #Sweepstakes, #ContestEntry (but not #sweeps)
- FTC reviewing the Guide, public comments due June 22nd (after initial extension).
- **Facebook Advertising Guidelines:** Cannot incentivize sharing through use of loyalty points, sweepstakes entries, etc.

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Privacy and Data Collection

- Loyalty programs are often used to collect personal information from participants...triggering potential privacy issues.
- What is being disclosed in your privacy terms? Are you aggregating and/or sharing sales and marketing data?
- The EU General Data Protection Regulation (GDPR) has strict requirements for processing of personal data, which in an increasingly global marketplace could affect information collected as part of loyalty programs.
- California is implementing its own comprehensive privacy law, the California Consumer Privacy Act, and other state laws may also prohibit sharing customer information.
 - **California** also has the Supermarket Club Card Disclosure Act of 1999, Cal. Civil Code Sec. 1749.60-1749.66.
 - *See also Illinois* Ill. Comp. Stat. 505/2JJ.

California Consumer Privacy Act (“CCPA”)

- Sweeping and controversial privacy legislation seeking to balance consumer privacy and business interests.
- Provisions are operative as of January 1, 2020, with enforcement scheduled to begin July 1, 2020.
- Grants a consumer various rights with regard to that consumer’s personal information a business holds.
- Prohibits a business from discriminating against the consumer for exercising any of the consumer’s rights under the CCPA.
 - **Exception: Business may offer different price/rate/level/quality of goods or services to a consumer if the differential treatment is reasonably related to the value provided to the consumer by the consumer’s data.**
 - Loyalty program sponsors must provide an additional notice to consumers that explains the program and its material terms, as well as how to opt in and an explanation that they can opt out and delete their data at any time, and ***an explanation of how their data is valued in relation to the program.***

CAN-SPAM/TCPA

- Are you following related marketing laws like CAN-SPAM and TCPA? Potential for significant liability.
- Incentivizing referral emails (*e.g.*, with additional rewards points) may trigger CAN-SPAM requirements.
 - CAN-SPAM Act establishes standards for sending non-deceptive commercial email (*e.g.*, no deceptive headers, must include “unsubscribe” option) PLUS sender must scrub referrals against internal “do-not-email” list.
 - Must take into account platform TOS: *e.g.*, incentivized programs may also violate Facebook platform rules.
- TCPA has become “hot” area for litigation with respect to loyalty programs— make sure you obtain express written consent to text your loyalty program members.
 - ***Geraci v. Red Robin Int'l***, Case No. 19-cv-01826-RM-KLM (D. Colo. 2020).
 - ***Frank v. Cannabis & Glass***, Case No. 2:19-cv-00250-SAB (E.D. Wash. 2019).

Antitrust

- Robinson-Patman Act § § 2(d)-(e), 15 U.S.C. § § 13(d)-(e): Offering a richer promotional program to one retailer vs. another could be discriminatory.
 - RPA has many requirements and we do not see as much government enforcement as there once was, but private litigants are still active.
 - Sections 2(d)-(e) (promotional allowances and services provisions do not require a showing of injury and thus are in effect strict liability).
 - ***Nicolosi Distributing, Inc. v. FinishMaster, Inc., Case No. 5:18-cv-03587*** (N.D. Cal. Comp. Filed June 15, 2018): alleges that a paint finishing supplier used its loyalty program to provide discounts that unreasonably restrained trade.
- Section 2(c) of the Robinson-Patman Act, 15 U.S.C. § 13(c), prohibits “commercial bribery,” and many states have similar provisions. Offering rewards programs to the employees of customers as part of a trade promotion may trigger these laws.
 - The best way to address the issue is to get employer consent to include employees in program.
 - *De minimis*/low-value gifts are often excluded.

Employee Loyalty Programs

Loyalty programs intended for employees trigger additional concerns:

- ***What should be included in the “regular rate of pay”*** under the federal Fair Labor Standards Act/states that follow it?
 - “**Regular rate of pay**” must include “all remuneration for employment paid to, or on behalf of, the employee,” subject to some exceptions. *See* 29 U.S.C. § 207(e). May exclude at least 2 types of payments:
 - **Excludes** discretionary bonuses, gifts, holiday bonuses or other bonuses on special occasions, service rewards, and other bonuses “the amounts of which are not measured by or dependent on hours worked, production, or efficiency.” 29 U.S.C. § 207(e)(1).
 - **Includes** performance bonuses.
- ***Points may qualify as wages*** under Section 200 of the California Labor Code and other similar state laws.
 - California law expressly prohibits the use of “scrip, coupon, cards” or other redeemable things as payment for wages. *See* Cal. Lab. Code § 212(a)--***may potentially be interpreted to bar the use of employee loyalty programs altogether.***
 - In many states, expiring any points that have been earned but have not been redeemed may be viewed as a forfeiture of wages in violation of state law.
 - While there is generally no black letter prohibition against expiring points, expiration should only be attempted based on a case-by-case analysis.
- ***In most states, only points given as discretionary bonuses or gifts (vs. performance bonuses) should be expired.***

Human Rights/Americans with Disabilities Act

- Is your loyalty program accessible to individuals with disabilities?
 - Title III of the Americans with Disabilities Act (ADA) prohibits discrimination on the basis of disability in places of public accommodation.
 - Courts are split as to (1) whether the ADA applies to websites; and (2) the degree to which it applies/under what circumstances.
 - Does the ADA apply only to websites that have a physical connection to goods and services available at a physical store or location?
- ***Nat'l Fed'n of the Blind v. The Container Store, Inc. (D. Mass. Aug. 25, 2016):*** Plaintiff sued Container Store alleging The Container Store's loyalty program discriminates against the blind because the in-store electronic devices on which customers could enroll cannot be independently used by blind customers.
 - *See also* Braille gift card suits
 - Other challenges include discrimination on basis of gender, age, etc.

Partnerships and Third-Party Agreements

- Many third parties may be involved in executing a loyalty program.
- Important to be clear about roles/requirements/dates, etc., but also to pay attention to legal compliance requirements.
 - *E.g.*, who is responsible for fulfillment? Registering sweepstakes? What are requirements regarding privacy/data security responsibilities?
 - Get representations and warranties about compliance.
 - Indemnification is nice, but get it backed up by insurance.
- Substantial assistance doctrine: all parties may be liable for consumer protection violations.
- Privacy:
 - What is a “sale” under the CCPA?
 - Are your partners compliant?
- Force majeure and COVID-19.

Wrap-Up/Practice Tips

- Upswing in litigation involving loyalty programs.
 - Courts are less inclined than they used to be to evaluate solely on contract terms.
 - Enforcers getting into action.
- Be careful to make sure your advertising is consistent with your terms and conditions—and to make sure your key terms are clearly and conspicuously disclosed.
- Consider the effect of new technologies—keep an eye on how the law is developing.
 - Digital consent.
 - Virtual currency and AML.
 - Charitable promotions and free action.
 - Unclaimed property.
- What does COVID-19 mean for these programs? Inability to provide rewards? Importance of terms, force majeure provision.

Questions?



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