

The New Federal Gift Card Regulations

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Spending on gift cards for the 2010 holiday season was expected to reach \$24.78 billion, with the average American spending approximately \$146 on gift cards.¹ The amount that holiday shoppers were expected to spend in 2010 was almost \$6 more than the previous year.² Given the obvious popularity of gift cards, most retailers likely feel obligated to offer gift cards to their customers. But retailers that sell or intend to start selling gift cards should proceed cautiously because more than forty states have consumer protection laws that govern them. Additionally, the federal government recently enacted a new law that establishes new minimum standards for gift card disclosures, expiration dates, service fees, and dormancy charges. Simply stated, a franchisor that currently sells or wishes to sell gift cards to its system's customers must become very familiar with the new federal gift card law and the many state laws that apply to the sale of gift cards.

This article provides a detailed description of the new federal gift card law and a basic road map of the various state laws. It also suggests steps that a franchisor can take to comply with the new federal gift card law and highlights issues that a franchisor should consider before establishing a gift card program. It is also important that franchisees become familiar with gift card laws because potential liability exists for sellers of gift cards as well as issuers under the new federal law. Franchisees also are typically obligated to comply with applicable law under their franchise agreements and should ensure that their implementation of any gift card program complies with state gift card regulations and unclaimed property laws.

NEW FEDERAL REGULATIONS

On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) was signed into law.³ The Credit CARD Act amended the Electronic Fund Transfer Act (EFT Act);⁴ imposed new requirements for expiration dates and dormancy, inactivity, and service fees associated with gift cards; and granted

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authority to the Board of Governors of the Federal Reserve System (Board) to promulgate regulations to implement these new requirements (federal gift card regulations).⁵ Pursuant to § 403 of the Credit CARD Act, the federal gift card regulations were to become effective on August 22, 2010. However, on July 27, 2010, Congress passed legislation amending § 403 of the Credit CARD Act to delay the effective date for certain gift card disclosure provisions⁶ to January 31, 2011, as long as certain conditions are satisfied.⁷

The federal gift card regulations apply to store gift cards, gift certificates, and general use prepaid cards.⁸ A store gift card is a card, code, or other device issued to a consumer in a specified amount that can be increased or reloaded by the consumer and

that can be redeemed for goods and services at a single merchant or an affiliated group of merchants.⁹ An affiliated group of merchants is defined as "two or more affiliated merchants or other persons that are related by common ownership or corporate control . . . and that share the same name, mark, or logo."¹⁰ In the franchise context, "the term includes franchisees that are subject to a common set of corporate policies or practices" pursuant to their franchise agreements.¹¹ Unless excluded under the federal gift card regulations, so-called closed loop cards are generally considered to be gift certificates or store gift cards. A gift certificate is basically a store gift card except that a gift certificate's value cannot be increased or reloaded.

A general use prepaid card is essentially the same as a store gift card except that it can be redeemed for goods and services at multiple unaffiliated merchants or used at ATMs.¹² Unless excluded under the federal gift card regulations, open loop cards are generally considered to be general use prepaid cards.¹³ One common example of a general use prepaid card is an open loop card issued by a bank that can be used at any retailer that accepts that card brand (e.g., VISA or MasterCard).¹⁴

The federal gift card regulations apply to both issuers and sellers of gift cards. Because franchisors usually manage or control the establishment of a franchise system's gift card program and franchisees sell the program's gift cards

to consumers, the federal gift card regulations apply to both franchisors and franchisees.

DISCLOSURES

The federal gift card regulations contain a complex array of disclosure requirements that may apply differently depending on the circumstances, e.g., whether a consumer purchases an instrument such as a card, code, or device in person or over the telephone. As noted below, certain disclosures must appear on the face of the gift card; others can be made on packaging, electronically, or verbally. If certain disclosures are made on accompanying contract documents rather than on the card itself, the disclosures will not comply with the “clear and conspicuous” disclosure requirements.¹⁵ Certain important disclosure requirements are summarized below:

- Dormancy, inactivity,¹⁶ and service fees¹⁷ must be disclosed on the card and be visible to the consumer without the need to remove packaging or other materials at the time of sale. The amount of such fees, how often fees may be assessed, and the fact that fees may be assessed for inactivity must be disclosed prior to purchase, regardless of whether a gift card is purchased in person, via the Internet, or by phone.¹⁸
- A toll-free phone number and a web address, if one is maintained, where consumers may obtain fee information or a replacement gift card must be disclosed.¹⁹
- Information regarding whether funds underlying a gift card may expire must be disclosed on the gift card.²⁰
- Electronic disclosures cannot be given through a hyperlink or in a manner where the purchaser can easily bypass the disclosure.²¹
- In situations where oral disclosures are allowed, written or electronic disclosures must also be made on or with the gift card.²²

EXPIRATION DATES

Under the federal gift card regulations, gift cards may not be sold or issued unless the expiration date of the underlying funds is at least five years after the date of issuance (for a gift certificate) or five years after the date funds were last loaded (for a store gift card or general use prepaid card).²³ This requirement can present complications because, in certain instances, the expiration date for the underlying funds can be different from the printed expiration date on the card. For example, if a consumer loads additional funds on a card with a printed expiration date that is less than five years after the date the funds are loaded, that card would violate the federal regulations. To address the possibility of consumer confusion regarding differences between the gift card expiration date and the expiration date for the underlying funds, the Board adopted an approach to ensure that consumers have an adequate period of time to spend gift card funds.²⁴ Specifically, policies and procedures must be in place to give consumers a reasonable opportunity to purchase a gift card

with at least five years remaining until the gift card expiration date.²⁵ The Board explained that consumers are deemed to have a reasonable opportunity to purchase a gift card with at least five years remaining until the gift card expiration date if (1) policies and procedures are in place to prevent the sale of a gift card that does not have an expiration date during the five years after the date that the gift card was sold or initially issued to a consumer, or (2) a gift card is available to consumers to purchase five years and six months before the gift card expiration date.²⁶

DORMANCY, INACTIVITY, AND SERVICE FEES

The federal gift card regulations prohibit dormancy, inactivity, or service fees on gift cards unless three conditions are satisfied.²⁷ First, there must be no activity on the card or certificate during the one-year period before the fee is imposed.²⁸ For purposes of this condition, the term activity relates to any action by the consumer to use the funds on the card or certificate (i.e., increasing, decreasing, or otherwise using the funds).²⁹ If a fee is imposed because one year has passed with no activity and the consumer then uses the card or certificate the following month, another fee cannot be imposed until another year of inactivity passes. Second, only one dormancy, inactivity, or service fee can be imposed in any given calendar month.³⁰ For example, if a dormancy, inactivity, or service fee is imposed on February 24, the next such fee could not be imposed until March 1 at the earliest. Finally, dormancy, inactivity, and service fees must be disclosed “clearly and conspicuously” on the card or certificate, and such disclosures must be provided to the consumer prior to purchase.³¹ Although the federal gift card regulations regulate the frequency of fees and require certain disclosures, they do not mandate or limit the amount of any fees imposed.

EXCLUSIONS

The federal gift card regulations exclude certain card products, including an electronic promise, plastic card, or payment code or device that falls into one of the following six categories:³²

- cards usable solely for telephone services;
- reloadable cards not marketed or labeled as a gift card;
- loyalty, award, or promotional gift cards;
- cards not marketed to the general public;
- cards issued in paper form only; and
- cards redeemable solely for admission to events or venues.

FEDERAL PREEMPTION

The federal gift card regulations do not preempt state laws if state laws provide greater consumer protection than the federal gift card regulations.³³ In the approximately ten states without gift card regulations, the federal gift card regulations establish a minimum standard for expiration

dates and dormancy, inactivity, and service charges. But for the states with their own gift card regulations, the analysis is more complex. Franchisors should carefully evaluate the differences between the federal gift card regulations and the applicable state regulations because many state regulations provide greater protection to consumers. The impact of the federal gift card regulations in these states will depend on the extent to which the state regulations address disclosures, the fees that can be charged in a given month, and the length of inactivity required before service fees can be charged. In other instances, it may be unclear whether the state or the federal regulatory system provides the greater consumer protection and therefore trumps the other.

One potential preemption issue involves the expiration date restrictions under the federal gift card regulations and the obligations under state unclaimed property, or escheat, laws. Escheat laws in many states require issuers of unused gift cards (or cards with unused balances) to transfer, or escheat, any remaining funds after a certain period of time to the state where the cardholder resides or the issuer is incorporated. Although time periods vary, funds typically must be transferred to the state either three or five years following the sale or the last use of the card.³⁴ As noted above, the expiration date requirements under the federal gift card regulations do not allow the funds to expire for at least five years. Thus, it is possible that issuers will be obligated to transfer unspent funds to certain states after three years while simultaneously being required to maintain adequate funds to cover the five-year expiration period required by the federal gift card regulations.³⁵

Because state escheat laws vary, the Board decided that it was not feasible or prudent to make a preemption determination that applied generally to all states. Upon request for a preemption determination with respect to a particular state's escheat law, the Board will apply the general preemption standards discussed previously to determine whether the state law is inconsistent with the federal gift card regulations.³⁶ In this scenario, the Board's analysis would be published for notice and comment; and, if the Board were to determine that the state law is preempted, the final determination would be published in the commentary. Franchisors should monitor the Board's activity and be prepared to act in response to a Board ruling if necessary. State escheat laws are discussed below in the section on state gift card regulations, and a reference chart is also provided on pages 189–90 that includes references to the various state escheat laws.³⁷

ENFORCEMENT ACTIONS

Failure to comply with the federal gift card regulations is a violation of the EFT Act. A merchant found liable for a violation of the federal gift card regulations is liable to the

consumer for (1) actual damages; (2) statutory damages of \$100 to \$1,000 for an individual action or up to \$500,000 or 1 percent of the merchant's net worth in a class action; and (3) the costs of the action, including reasonable attorney fees.³⁸ The Federal Trade Commission (FTC) has the authority to enforce compliance with the requirements of the EFT Act.³⁹ If a violation of the federal gift card regulations occurs, it will be considered a violation of the FTC Act.⁴⁰ The FTC has

the authority to commence a civil action to recover penalties for violations of the federal gift card regulations under the FTC Act.⁴¹

Prior to enactment of the federal gift card regulations, FTC law enforcement actions regarding gift cards focused on violations of the

FTC Act. In its first gift card enforcement action in 2007, the FTC alleged that Kmart Corporation engaged in deceptive or unfair practices in the advertisement and sale of its Kmart gift cards.⁴² In particular, the FTC claimed that Kmart advertised its Kmart gift cards as cash equivalents, even though dormancy fees were charged after two years of nonuse; misrepresented that the gift cards would never expire; and failed to include proper disclosures. The problems with Kmart's gift card program included disclosures in legalese located in fine print on the back of the gift card, failure to make pre-sale disclosures for online sales, and packaging of gift cards in a manner that completely concealed the disclosures until the packaging was removed. Kmart and the FTC settled the matter in 2007 with Kmart agreeing (1) to disclose clearly and prominently any expiration dates and fees in all advertising and on the front of the gift card; (2) to disclose clearly and prominently, at the point of sale and prior to purchase, all material terms and conditions of any expiration dates and fees; (3) not to misrepresent any material terms and conditions of the gift card; (4) not to collect dormancy fees on any cards sold prior to the date the proposed order was issued; (5) to refund all dormancy fees for consumers who provide the number for the affected gift card; and (6) to publicize the refund program on its website.⁴³

In its second enforcement action, also initiated in 2007, the FTC alleged that Darden Restaurants, Inc. failed to adequately disclose its dormancy fees.⁴⁴ Specifically, the FTC argued that the following fee disclosure practices were inadequate: (1) disclosing the fee in fine print on the back of gift cards that was obscured by other information; (2) marketing transparent gift cards with a red lobster on the front that hid the disclosure; (3) marketing cards to consumers in restaurants without notifying them of the fee; and (4) selling cards on the company websites without disclosing prior to purchase that a fee may apply.⁴⁵ Darden Restaurants, which owns the Olive Garden, Red Lobster, Smokey Bones, and Bahama Breeze chains, eventually settled the matter and agreed to disclose clearly and prominently all automatic fees and expiration dates in its advertising, at the point of sale,

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and on the actual card.⁴⁶ Darden was also required to restore all dormancy fees and publicize the restoration program on its website for a two-year period.⁴⁷

STATE GIFT CARD REGULATIONS

Depending on the wording of the state statute and the state attorney general's attention to gift card matters, franchisors and franchisees may both be liable for violations of state gift card regulations. Approximately forty states have gift card regulations, and many have escheat laws that will impact a franchise system's gift card program. Similar to the federal gift card regulations, but in many cases more restrictive, state gift card laws focus on disclosures, expiration dates, and fees. At issue are fees that decrease the balance of the gift card, such as dormancy fees, replacement card fees, and other service fees. Because the federal gift card regulations may not preempt state law in many instances, franchisors that intend to establish a gift card program should carefully analyze all applicable state gift card regulations, many of which contain disclosure requirements that are different than the federal gift card regulations, as well as additional expiration date restrictions and fee restrictions. This exercise is critical if the franchisor intends to impose expiration dates or charge fees. State gift card regulations may also provide an additional set of exemptions and exclusions and allow the customers to redeem the balance of their gift cards for cash under certain circumstances. An in-depth discussion of state gift card regulations and escheat laws, which vary greatly from state to state, is beyond the scope of this article, but the following summarizes certain important topics and highlights issues of which franchisors and franchisees should be aware.

The gift card regulations vary greatly on the issue of expiration dates. California, Connecticut, Florida, Maine, Minnesota, Montana, New Hampshire, Rhode Island, and Washington all prohibit expiration dates on gift cards.⁴⁸ Of the many states that allow expiration dates, Arizona, Georgia, Nebraska, Nevada, New York, North Carolina, Oregon, South Dakota, Texas, Utah, and Virginia all require that the expiration date be disclosed.⁴⁹ Further adding to the complexity regarding expiration dates, many states allow for expiration dates but require that the gift card remain valid for a certain minimum time period.⁵⁰

Many states have regulations that govern the fees that a gift card issuer can charge. Connecticut, Florida, Illinois, Kentucky, Massachusetts, Michigan, Minnesota, Montana, New Hampshire, New Mexico, North Dakota, Oregon, Rhode Island, and Vermont are examples of states that prohibit a gift card issuer from charging service fees.⁵¹ Although other states allow a gift card issuer to charge fees, these fees often must be disclosed to the customer.⁵² In the states that

allow a gift card issuer to charge fees, a number provide that fees cannot be charged for a specified period of time after the card is purchased,⁵³ and others allow fees only in very limited circumstances.⁵⁴

ESCHEAT LAWS

Escheat of funds associated with gift cards, discussed above in the context of preemption, poses several challenges for franchisors either operating or considering a gift card program. In addition to imposing varying time periods in which they require unclaimed property to be escheated, many states have instituted reporting obligations with respect to unclaimed property. These requirements vary from state to state. The first step of ensuring compliance with escheat laws is to identify which laws among the fifty states (as well as the District of Columbia) are applicable.⁵⁵ Factors that impact that assessment, among others,

include the unclaimed property holder's domicile (i.e., the state of incorporation or formation of the franchisor, not its principal place of business), the gift card owner's residence, and the state in which the gift card was purchased. As a general rule, priority between states with respect to the right to escheat gift card funds is determined by a trilogy of U.S. Supreme Court cases. Under the primary rule, the state of the creditor/owner's last known address as shown on the debtor's record has the first right to escheat.⁵⁶ If the primary rule does not apply because this information does not appear on the debtor's records or that state does not require escheat, then the secondary rule provides that the state of incorporation of the debtor has priority to escheat the unclaimed property.⁵⁷ The third rule, frequently referred to as the "state of transaction" rule, applies when the first two rules are not applicable.⁵⁸ Notably, many gift card issuers seek to avoid the escheat of gift card funds by relying on the secondary rule and incorporating in a state that does not escheat gift card funds. In this scenario, the primary rule is avoided by not collecting any information on the owner or purchaser of the gift card. However, some states have amended or are amending their laws to impose new or additional reporting obligations in an effort to collect additional unused gift card funds.⁵⁹ Notably, states are also continuing to amend or propose amendments to their escheat statutes to exempt gift card funds, bringing the total number of such states to approximately thirty, as long as the gift cards associated with such funds do not have expiration dates.⁶⁰

As a general rule, once funds from unclaimed gift cards are escheated to a state, they are likely to remain with that state indefinitely. However, it is conceivable that a customer with an unused balance may attempt to redeem the balance, in which case the holder of the previously escheated funds would have a legitimate basis for reclaiming such funds from

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the state. As the foregoing makes clear, franchisors (or the entity holding gift card funds) should consider using technology that permits tracking balances so that any previously escheated funds may be netted out of the amount due with ensuing filings. Although a complete discussion of escheat laws is beyond the scope of this article, a list of escheat law citations are included in the reference chart on pages 189–90.

REDEMPTION FOR CASH

A minority of state statutes include provisions that require merchants to redeem a customer's gift card for cash. In California, a gift card is redeemable for cash if the cash value on the card is less than \$10.⁶¹ In Colorado, a gift card is redeemable for cash if the amount remaining on the card is \$5 or less.⁶² In Maine, Montana, and Washington, a gift card is redeemable for cash if the amount remaining on the card is less than \$5.⁶³ In Massachusetts, a customer has the option to redeem the remaining balance in cash (1) if the gift card is nonreloadable and 90 percent of the value has been redeemed or (2) if the gift card is reloadable and the balance is \$5 or less.⁶⁴ In Rhode Island and Vermont, a gift card is redeemable for cash if the remaining balance is less than \$1.⁶⁵ Interestingly, a merchant is not required to redeem a gift card for cash in Kansas.⁶⁶

CONSIDERATIONS FOR FRANCHISORS

The impact of federal and state gift card laws depends on the reach of the franchise system's gift card program. With the enactment of the federal gift card regulations, now is a good time for franchisors to update their existing gift card program. If franchisors intend to design a new gift card program, they should assess a number of considerations in the planning stages to establish a successful and compliant program. This section highlights important items that franchisors should consider and address when updating or designing a gift card program.

CORPORATE STRUCTURE AND TAX ISSUES

Franchisors should give serious consideration to corporate structure and tax issues. For instance, many companies form a subsidiary to manage their gift card program and administer the intake and payout of gift card funds. In this approach, the company will want to ensure that the structure it chooses for its gift card program allows it to obtain favorable tax treatment for the gift card entity. In recent years, the IRS has issued advice to some gift card companies, concluding that they did not qualify for income deferral on gift card revenue where the gift card company did not itself sell or provide the goods for which the cards were sold. Although this advice is not binding on other taxpayers, it is instructive. Various tax professionals have urged the IRS to reconsider its position that gift card receipts are payments over which the taxpayer exercises complete control and instead to treat gift card receipts as deposits.⁶⁷ Deposits are generally not taxable because they

are subject to being refunded. Franchisors are well advised to explore these issues with their attorneys, accountants, and tax advisers to determine the best approach.

CENTRAL GIFT CARD ACCOUNT

Another important consideration is to determine how the franchisor will hold the gift card funds. Although it may seem obvious, franchisors would be well advised to require all gift card funds be held in a central gift card account that the franchisor (or an affiliate) controls. When a gift card is sold by a franchisee, those funds would not be treated as the franchisee's revenue. Rather, the funds would be regularly transferred from the franchisee's account into the central gift card account. There are many reasons to adopt this approach. When a gift card is redeemed by the customer, it may not be redeemed at the same location where it was purchased. To ensure that the location providing the products or services receives payment, the appropriate funds would be transferred from the central gift card account to the appropriate franchisee's account soon after the gift card was used. Another important reason to set up a central gift card account is to place the gift card funds out of reach from financially troubled franchisees that may misuse the funds or later file for bankruptcy. Keeping those funds separate from franchisees until the redeeming purchase is made eliminates the risk to customers if franchisees were to hold gift card funds individually.

EVALUATION OF PREVIOUS GIFT CARD PROGRAMS

Finally, it is important to look at the gift cards offered in the past, both with and without the franchisor's authorization. Perhaps an old gift card has not been removed from some stores despite a request to discontinue it. Some franchisees may be offering store promotions through social media that the franchisor has not approved. The types of cards to be included in any franchisor's program could include a mixture of promotional gift certificates, to be used only at a specific store during its grand opening, for example, and reloadable gift cards redeemable at any store in the system. What works in one system may not work in another; it is important to examine what has worked in the past when planning for the future.

REVISING DOCUMENTS FOR SYSTEMWIDE PARTICIPATION

As a general rule, franchisors should require mandatory systemwide participation in gift card programs rather than permit voluntary participation by franchisees.⁶⁸ For a franchisor that is considering implementing a new gift card program, the first step is to review prior franchise agreements and disclosure documents to determine whether they contain language that permits mandatory participation. If these documents do not contain appropriate language, franchisors should consider creating incentives for franchisees to participate in the program. For example, franchisees will be more likely to participate in the program if the franchisor

can make a convincing case for the economic benefit and the increased customer loyalty that the program will create. In addition, franchisors should consider giving franchisees financial incentives to buy new equipment or software if expenditures are necessary to participate in the program. Of note, franchisors are likely to benefit from franchisees' purchase of new equipment in the long run, such as new point-of-sale terminals, because these types of equipment will likely make it easier to monitor gift card use and other sales activities. Creating a rewards program for stores selling the most cards is another incentive worth considering.

In addition to reviewing previous franchise agreements and disclosure documents, franchisors considering implementing a gift card program should evaluate whether they will need to incorporate additional disclosures into their disclosure documents, whether franchise agreements need to be revised, whether additional policies and procedures need to be incorporated into their operations manuals, and whether separate agreements need to be drafted to address franchisee responsibilities and obligations as well as the costs and expenses associated with such a program. Many operations manuals, disclosure documents, and franchise agreements currently in effect were written before gift cards became so prevalent in retail stores. If participation is not currently mandatory, franchisors should revise their disclosure documents and template agreements by including broadly worded disclosures about possible gift card programs and expenses related to them in order to reserve the right to require gift card program participation in the future. Of significance, disclosing that there may be required expenditures for a future gift card program can avoid later claims of inadequate disclosure by franchisees, as happened in the Coffee Beanery system.⁶⁹ In addition, franchisors should reserve the right to use national advertising funds to implement a gift card program in both the disclosure document and the franchise agreement.

TRAINING FRANCHISEES

Franchisors should determine how best to train franchisees and their employees to ensure compliance with the federal gift card regulations. For example, franchisors should anticipate establishing sales and marketing procedures to ensure that cards are not sold with a stated expiration date that violates the federal gift card regulations. Franchisees need training in advance to be sure that gift cards are marketed and displayed properly. If applicable, franchisors (and their franchisees) should stop selling paper gift certificates, develop a deadline for redeeming paper gift certificates, and publicize the new card program with website and in-store information. At a minimum, a franchisee's employees will require training on the sale, redemption, and reloading of gift cards. If a franchisee distributes reloadable cards that are not intended to be marketed as gift cards, the franchisee must be careful about how the cards are displayed to the customer to eliminate confusion regarding whether the cards are gift cards.

Store employees should be prepared to answer questions from customers related to applicable state regulations and

the federal gift card regulations. For example, in a 2009 action against Starbucks Corporation to enforce California's gift card laws, the district attorneys of three California counties (Monterey, Sonoma, and Shasta) alleged that Starbucks retail stores had failed upon request to pay customers cash for the remaining value of gift cards worth less than ten dollars. The district attorneys sought civil penalties of \$2,500 for each violation in addition to the costs of investigation and restitution. Starbucks was required to pay a civil penalty of \$195,000, plus \$20,000 in investigation costs and \$10,000 to the state's Consumer Protection Prosecution Trust Fund. Additionally, Starbucks was required to implement a compliance program for its company-owned California stores to instruct its employees to redeem gift cards with less than ten dollars in remaining value for cash or a check.⁷⁰

DESIGNING A NEW GIFT CARD

Franchisors should consider what the actual gift card will look like after the new disclosures are added. Much of the limited space on a standard gift card is already occupied by items such as the magnetic strip, the franchise system logo, state-specific consumer protection disclosures, and the card number. The federal gift card regulations include many specific requirements about what must be included on the face of a plastic gift card and how such information must be displayed. As such, franchisors should consult the regulations to get a head start on designing gift cards that comply with the new federal gift card regulations. In addition to considering the gift card's appearance, franchisors should evaluate whether any disclosures that are not on the face of the card are adequate. As discussed above, the federal gift card regulations clearly specify that electronic disclosures cannot be given through a hyperlink or in a manner where the purchaser can easily bypass the disclosure. If a franchisor decides not to impose fees and expiration dates, however, some of the new disclosures will not be required. Many franchisors have chosen to eliminate fees and expiration dates to avoid disclosures and to simplify use of the gift card by consumers and franchisees.

WHICH STATE LAWS APPLY?

If the franchisor only has locations in a handful of states, it may initially be necessary only to become familiar with the laws of those states in addition to federal law. But if a franchisor has locations in many states or anticipates expanding, it should design the gift card program to comply with the laws of each state where stores are now or will be located in the near future. In addition to the gift card and escheat laws discussed above, other laws may come into play. For instance, if customers are asked to register their gift cards online or otherwise, they are likely to provide personal information that must be maintained in accordance with applicable privacy laws. Further, franchisors and franchisees must be prepared to comply with advertising, sales and use taxes, and other laws.

HIRING A VENDOR

Franchisors should consider hiring a third-party vendor to handle the funds paid for gift cards and to transfer those funds out of franchisee accounts frequently. In that case, they should retain an established, reputable third-party vendor that has experience with multistate franchise systems. Many vendors offer a wide range of services and exercise varying degrees of control over gift card programs in keeping with the desires of the franchisor, and good vendors may provide training materials or assistance to educate franchisors and franchisees on displaying, selling, and redeeming gift cards. A vendor that manages the gift card funds and takes more responsibility for administering the program may have a greater stake in complying with the law and making sure that franchisees and their employees receive appropriate training. Additionally, a reputable vendor can assist franchisors with detecting and preventing fraud by identifying and flagging unusual activity on cards or potential purchases of gift cards made with stolen credit cards.

CONCLUSION

Without question, operating a gift card program and complying with the various regulations is difficult and complicated, and the level of difficulty and risk increases if a franchisor desires to impose expiration dates and fees. For these very reasons, in addition to concerns related to customer satisfaction, many companies have decided not to use expiration dates or impose fees. But smaller systems operating in a limited number of states with gift card regulations and escheat laws that are not overly restrictive may decide to use expiration dates and impose fees. Regardless of the approach taken, it remains important for franchisors and franchisees to understand the legal framework that governs their system's gift card program.

ENDNOTES

1. Press Release, Nat'l Retail Fed'n, Gift Givers Listening to Recipients as Gift Card Spending Expected to Rise (Nov. 17, 2010), available at www.nrf.com.
2. *Id.*
3. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734-66.
4. Electronic Fund Transfer Act, 15 U.S.C. § 1693 et seq.
5. 12 C.F.R. § 205 et seq.
6. Provided certain conditions are satisfied, the final rule delays the effective date of the following provisions until January 31, 2011: (1) the requirement that a certificate or card must contain on its face a disclosure about any dormancy, inactivity, or services fees; (2) the required disclosure of the expiration date for the underlying funds or the fact that such funds do not expire; (3) the requirement for policies and procedures to ensure that a consumer will have a reasonable opportunity to purchase a certificate or card with at least five years remaining until the expiration date; and (4) the required disclosures of information about expiration, replacement cards, and fees, and

of toll-free numbers and website information for obtaining replacement certificates or cards and fee information. The July 27, 2010, legislation was implemented by a Board rule issued on October 19, 2010, that finalized the Board's interim rule published in the *Federal Register* on August 17, 2010.

7. To take advantage of the delayed effective date, a certificate or card issuer must meet certain conditions: (1) complying with Regulation E's substantive restrictions on fees; (2) not imposing an expiration date for underlying funds; and (3) making certain alternative disclosures through in-store signage, messages during customer service calls, websites, and general advertising.

8. 12 C.F.R. § 205.20 et seq., available at www.federalreserve.gov/newsevents/press/bcreg/bcreg20100811a1.pdf.

9. *Id.* § 205.20(a)(2).

10. Supplement I to Part 205—Official Staff Interpretations, § 205.2—Definitions ¶ 20(a)(2)—Store Gift Card [hereinafter Official Staff Interpretations].

11. *Id.*

12. 12 C.F.R. § 205.20(a)(3).

13. *Id.*

14. For further discussion of open and closed loop gift cards, please see the official commentary to the federal gift card regulations. Electronic Fund Transfers, 75 Fed. Reg. 16,580 (Mar. 23, 2010).

15. 12 C.F.R. § 205.20(c)(1).

16. Dormancy fees and inactivity fees are fees for the nonuse of or inactivity on a gift card. *Id.* § 205.20(a)(5).

17. Service fees are periodic fees for holding or use of a gift card. *Id.* § 205.20(a)(6).

18. *Id.* § 205.20(d).

19. *Id.* § 205.20(e).

20. *Id.*

21. Official Staff Interpretations, *supra* note 10, ¶ 20(c)(2).

22. 12 C.F.R. § 205.20(c)(4).

23. *See id.* § 205.20(e)(2). "Expiration" of the funds, for these purposes, means that the funds are no longer available for redemption by the holder of the gift card. Depending on the applicable state laws, the holder of the funds may keep those funds itself or may escheat them to one or more states as unclaimed property.

24. *Id.*

25. *Id.*

26. The Board initially proposed two alternatives, entitled Alternative A and Alternative B, for determining whether the expiration date restrictions were satisfied. *See* 74 Fed. Reg. 60,986 (Nov. 20, 2009). The Alternative B approach was incorporated into the federal gift card regulations. *See* 12 C.F.R. § 205.20(e)(2); *see also* Official Staff Interpretations, *supra* note 10, ¶ 20(e)(1).

27. 12 C.F.R. § 205.20(d).

28. *Id.* § 205.20(d)(1).

29. *Id.* § 205.20(a)(7).

30. *Id.* § 205.20(d)(3).

31. *Id.* § 205.20(d)(2).

32. *Id.* § 205.20(b).

33. *See id.* § 205.12(b).

34. A number of states have abandonment periods that may be shorter than five years, including, for example, Montana, Nebraska, New Mexico, and North Carolina. In addition, a number of states expressly exempt gift certificates from the applicable escheat

provisions, including, for example, Maryland and Minnesota; however the express exemption language is not applicable to standard gift cards.

35. *See, e.g.*, Comment Letter from Network Branded Prepared Card Association to Jennifer J. Johnson, Bd. of Governors of the Fed. Reserve Sys. (Dec. 15, 2009).

36. *See also* 12 C.F.R. § 205.12(b)(2).

37. In addition, a helpful summary of the relevant provisions for each state can be found on the National Conference of State Legislature's website, *available at* www.ncsl.org.

38. 15 U.S.C. § 1693m(a).

39. *Id.* § 1693o(c). Note, however, that violations of the federal gift card regulations by banks are enforced by other governmental agencies. *Id.* § 1693m(a).

40. 15 U.S.C. § 1693o(c).

41. 15 U.S.C. § 45(m). The FTC also has the ability to issue cease-and-desist orders against a merchant for potential violations. *Id.* § 45(b).

42. *In re* Kmart Corp., Kmart Servs. Corp. & Kmart Promotions, LLC, FTC File No. 062 3088, *available at* <http://www.ftc.gov/os/caselist/0623088/0623088do.pdf>.

43. *Id.*

44. *In re* Darden Rests., Inc., GMRI Inc. & Darden GC Corp., FTC File No. 062 3112 (2007), *available at* www.ftc.gov/os/caselist/0623112/index.shtml.

45. *Id.*

46. *Id.*

47. *Id.*

48. CAL. CIV. CODE § 1749.5(a)(1); CONN. GEN. STAT. § 42-460(a); FLA. STAT. § 501.95(2)(a); ME. REV. STAT. ANN. tit. 33, § 1953.1.G; MINN. STAT. § 325G.53.2; MONT. CODE ANN. § 30-14-108(1); N.H. REV. STAT. ANN. § 358-a:2, XIII; R.I. GEN. LAWS § 6-13-12; WASH. REV. CODE § 19.240.020(1)(a).

49. ARIZ. REV. STAT. ANN. § 44-7402; GA. CODE ANN. § 10-1-393(b)(33)(A)(ii); NEB. REV. STAT. § 69-1305.03(e); NEV. REV. STAT. § 598.0921(1)(a); N.Y. GEN. BUS. LAW § 396i; N.C. GEN. STAT. § 66-67.5(a); OR. REV. STAT. § 646A.278; S.D. CODIFIED LAWS § 39-1-55(B); TEX. BUS. & COM. CODE ANN. § 35.42; UTAH CODE ANN. § 13-11-4; VA. CODE ANN. § 59.1-531.A.

50. *See* ARK. CODE ANN. § 4-88-703; HAW. REV. STAT. § 481B-13; 815 ILL. COMP. STAT. 505/2SS(b); KAN. STAT. ANN. § 50-6108; KY. REV. STAT. § 367.890; LA. REV. STAT. ANN. § 51:1423(B)(1); MD. CODE ANN., COM. LAW § 14-1319; MASS. GEN. LAWS ANN. ch. 200A, § 5D; MICH. COMP. LAWS § 445.903g; N.M. STAT. ANN. § 57-12-26(B); N.J. STAT. ANN. § 56:8-110, 1.a(1); N.D. CENT. CODE § 51-29-02; OKLA. STAT. tit. 15, § 797, A.1; OHIO REV. CODE ANN. § 1349.61(A)(1); S.D. CODIFIED LAWS § 39-1-55(B) (cannot expire before the first anniversary of the date the card was sold unless the expiration date is disclosed as required); TENN. CODE ANN. § 47-18-127(a); VT. STAT. ANN. tit. 8, § 2702.

51. CONN. GEN. STAT. § 3-65c; FLA. STAT. § 501.95; 815 ILL. COMP. STAT. 505/2SS; KY. REV. STAT. ANN. § 367.890; MASS. GEN. LAWS ANN. ch. 200A, § 5D; MICH. COMP. LAWS § 445.903f; MINN. STAT. § 325G.53; MONT. CODE ANN. § 30-14-108(3); N.H. REV. STAT. ANN. § 358-a:2, XIII; N.M. STAT. ANN. § 57-12-26(C); N.D. CENT. CODE § 51-29-02; OR. REV. STAT. § 646A.276; R.I. GEN. LAWS § 6-13-12; VT. STAT. ANN. tit. 8, § 2703.

52. *See, e.g.*, GA. CODE ANN. § 10-1-393(33)(A); N.J. STAT. ANN. § 56:8-110, 1.b; N.M. STAT. ANN. § 57-12-26(B); S.D. CODIFIED LAWS § 39-1-55(C); TEX. BUS. & COM. CODE § 35.42; UTAH CODE ANN. § 13-11-4; VA. CODE ANN. § 59.1-531.B.

53. *See, e.g.*, ARK. CODE ANN. § 4-88-703; KAN. STAT. ANN. § 50-6108; MD. CODE ANN., COM. LAW § 14-1319; NEV. REV. STAT. § 598.0921, 1(c)(2); N.J. STAT. ANN. § 56:8-110, 1.a(2); N.Y. GEN. BUS. LAW § 396i; N.C. GEN. STAT. § 66-67.5(a); OHIO REV. CODE ANN. § 1349.61(A)(2); TENN. CODE ANN. § 47-18-127(b).

54. *See, e.g.*, IOWA CODE § 556.9; OKLA. STAT. tit. 15, § 797.D; WASH. REV. CODE § 19.240.040.

55. *See* *Texas v. New Jersey*, 379 U.S. 674 (1965) (setting the applicable precedent for determining which state has priority in receiving unclaimed property).

56. *Id.*

57. *See* *Pennsylvania v. New York*, 407 U.S. 206 (1972).

58. *See* *Delaware v. New York*, 507 U.S. 490 (1993).

59. For example, in July 2010, New Jersey amended its unclaimed property law, N.J. STAT. ANN. §§ 46:30B-1 et seq., to impose information collecting and reporting obligations and to provide for the custodial escheat of stored value cards. The proposed amendment contained the following language: "If the issuer of a stored value card does not have the name and address of the purchaser or owner of the stored value card, the address of the owner or purchaser of the stored value card shall assume the address of the place where the stored value card was purchased or issued and shall be reported to New Jersey if the place of business where the stored value card was sold or issued is located in New Jersey." 2010 N.J. Laws ch. 25c; N.J. STAT. ANN. § 46:30B-42.1c. Among others, the New Jersey Retail Merchants Association challenged the law. On November 13, 2010, two days before the law was to become effective, the court issued an injunction, holding that plaintiffs were likely to succeed on the merits because of the priority rules set forth in *Texas v. New Jersey*, 379 U.S. 674 (1965). *See* *Am. Express Travel Related Servs. Co., Inc. v. Sidamon-Eristoff*, Civil No. 10-4890 (FLW) (D.N.J. Nov. 13, 2010).

60. *See, e.g.*, ARIZ. REV. STAT. § 44-301.15; UTAH CODE ANN. § 67-4a-211 (effective July 1, 2011).

61. CAL. CIV. CODE § 1749.5(b).

62. 2010 Colo. Sess. Laws ch. 180.

63. ME. REV. STAT. ANN. tit. 33, § 1953(G); MONT. CODE ANN. § 30-14-108(4); WASH. REV. CODE § 19.240.020(3).

64. MASS. GEN. LAWS ANN. ch. 200A, § 5D.

65. R.I. GEN. LAWS § 6-13-12; VT. STAT. ANN. tit. 8, § 2704.

66. KAN. STAT. ANN. § 50-6108(b).

67. *See, e.g.*, Paul C. Lau, *Tackling Taxes—Tackling Gift Card Sales: Current or Deferred Revenue?* (pts. 1, 2), TAXES (Feb. 1, 2010; Apr. 1, 2010).

68. For example, if a gift card cannot be used at all locations in the franchise system, it is important to clearly communicate this fact to the consumer to help protect against a potential claim under a state's consumer protection law.

69. *Coffee Beanery Ltd. v. WW LLC*, 501 F. Supp. 2d 955 (E.D. Mich. 2007), *rev'd*, No. 07-1830 (6th Cir. Aug. 18, 2008), *cert. denied*, No. 08-1396 (U.S. Oct. 5, 2009).

70. *People v. Starbucks Corp.*, No. 166948 (Cal. Super. Ct. Aug. 13, 2009) (final judgment and injunction per stipulation).

STATE GIFT CARD STATUTES AND STATE ESCHEAT LAWS

State	Laws Addressing Expiration Dates and Fees*	Escheat Laws
Alabama	N/A	ALA. CODE § 35-12-72(a)(17), (b)
Alaska	N/A	ALASKA STAT. § 34.45.240
Arizona	ARIZ. REV. STAT. ANN. § 44-7402	ARIZ. REV. STAT. ANN. § 44-301(15)
Arkansas	ARK. CODE ANN. § 4-88-703	ARK. CODE ANN. § 18-28-201(13)(B)(i)
California	CAL. CIV. CODE § 1749.5	CAL. CIV. PROC. CODE § 1520.5
Colorado	COLO. REV. STAT. § 6-1-722	COLO. REV. STAT. § 38-13-108.4
Connecticut	CONN. GEN. STAT. §§ 42-460, 3-65c	CONN. GEN. STAT. § 3-73a
Delaware	N/A	DEL. CODE ANN. tit. 12, § 1197; tit. 67, § 1212
District of Columbia	N/A	D.C. CODE ANN. § 41-114
Florida	FLA. STAT. § 501.95	FLA. STAT. § 717.1045
Georgia	GA. CODE ANN. § 10-1-393(b)(33)(A)(ii)	GA. CODE ANN. § 44-12-205
Hawaii	HAW. REV. STAT. § 481B-13	HAW. REV. STAT. §§ 523A-14, 523A-3
Idaho	IDAHO CODE ANN. § 14-514	IDAHO CODE ANN. §§ 14-501(10)(b), 14-502(2)
Illinois	815 ILL. COMP. STAT. 505/2SS	765 ILL. COMP. STAT. 1025/10.6
Indiana	N/A	IND. CODE § 32-34-1-1
Iowa	IOWA CODE § 556.9.2	IOWA CODE § 556.9
Kansas	KAN. STAT. ANN. § 50-6108	KAN. STAT. ANN. § 58-3934
Kentucky	KY. REV. STAT. ANN. § 367.890	KY. REV. STAT. ANN. § 393.010
Louisiana	LA. REV. STAT. ANN. § 51:1423	LA. REV. STAT. ANN. §§ 9:151 et seq.
Maine	ME. REV. STAT. ANN. tit. 33, § 1953(G)	ME. REV. STAT. ANN. tit. 33, § 1953(G), (G-1)
Maryland	MD. CODE ANN., COM. LAW §§ 14-1319, 1320	MD. CODE ANN., COM. LAW § 17-101(m)
Massachusetts	MASS. GEN. LAWS ANN. ch. 200A, § 5D; ch. 266, §§ 75C, 75D, 75E	N/A
Michigan	MICH. COMP. LAWS § 445.903e, f, g	MICH. COMP. LAWS § 567.235
Minnesota	MINN. STAT. § 325G.53	MINN. STAT. § 345.39
Mississippi	N/A	MISS. CODE ANN. § 89-12-15
Missouri	N/A	MO. REV. STAT. §§ 447.500 et seq.

STATE GIFT CARD STATUTES AND STATE ESCHEAT LAWS

State	Laws Addressing Expiration Dates and Fees*	Escheat Laws
Montana	MONT. CODE ANN. § 30-14-108(1), (3)	MONT. CODE ANN. § 70-9-803(g)
Nebraska	NEB. REV. STAT. § 69-1305.03(e), (f)	NEB. REV. STAT. § 69-1305.03
Nevada	NEV. REV. STAT. § 598.0921(1)(a), (b)	NEV. REV. STAT. ANN. §§ 120A.010 et seq.
New Hampshire	N.H. REV. STAT. ANN. § 358-a:2, XIII	N.H. REV. STAT. ANN. §§ 358-A:2, 471-C:1 et seq.
New Jersey	N.J. REV. STAT. § 56:8-110(1)	N.J. REV. STAT. §§ 46:30B-1 et seq.
New Mexico	N.M. STAT. ANN. § 57-12-26(B), (C)	N.M. STAT. ANN. § 7-8A-2(A)(7)
New York	N.Y. GEN. BUS. LAW § 396-i(3), 5(b)	N.Y. ABAND. PROP. LAW § 1315
North Carolina	N.C. GEN. STAT. § 66-67.5(a)	N.C. GEN. STAT. §§ 116B-53(c)(8), -54(b)
North Dakota	N.D. CENT. CODE § 51-29-02	N.D. CENT. CODE §§ 47-30.1-01 et seq.
Ohio	OHIO REV. CODE ANN. § 1349.61	OHIO REV. CODE ANN. § 169.01(B)(2)(d)
Oklahoma	OKLA. STAT. tit. 15, § 797	OKLA. STAT. tit. 60, §§ 651 et seq.
Oregon	OR. REV. STAT. §§ 646A.276, .278	OR. REV. STAT. §§ 98.302 et seq.
Pennsylvania	N/A	72 PA. CONS. STAT. §§ 1301 et seq.
Rhode Island	R.I. GEN. LAWS § 6-13-12	R.I. GEN LAWS §§ 33-21.1-1 et seq.
South Carolina	N/A	S.C. CODE ANN. §§ 27-18-10 et seq.
South Dakota	S.D. CODIFIED LAWS § 39-1-55(B), (C)	S.D. CODIFIED LAWS § 43-41B-15
Tennessee	TENN. CODE ANN. § 47-18-127	TENN. CODE. ANN. § 66-29-135
Texas	TEX. BUS. & COM. CODE ANN. § 35.42	TEX. PROP. CODE ANN. § 72.1016
Utah	UTAH CODE ANN. § 13-11-4	UTAH CODE ANN. § 67-4a-211
Vermont	VT. STAT. ANN. tit. 8, §§ 2702, 2703	VT. STAT. ANN. tit. 27, §§ 1241 et seq.
Virginia	VA. CODE ANN. § 59.1-531	VA. CODE ANN. § 55-210.8:1
Washington	WASH. REV. CODE §§ 19.240.020(1)(a), 19.240.030, 19.240.040	WASH. REV. CODE §§ 63.29.140, 19.240.005 et seq.
West Virginia	N/A	W. VA. CODE § 36-8-2(a)(7)
Wisconsin	N/A	Wis. STAT. §§ 177.01 et seq.
Wyoming	N/A	WYO. STAT. ANN. § 34-24-114

* For information about pending legislation, see National Conference of State Legislature website, *available at* www.ncsl.org.