

Gift Cards, Coupons, and Loyalty Programs... A Gift or Liability?

April 29, 2015

Today's Agenda

- Brief overview of stored value product offerings
- Federal and State gift card laws
- Unclaimed property implications for gift cards
 - Holder's rights and State challenges to issuers
 - *Card Compliant* case update
- Consumer protection enforcement & class action trends
- Current landscape
- Planning considerations
- Q&A

Moderator – Walter Nagel



Crowell & Moring LLP

Partner, Tax

Government Experience

U.S. Advisory Commission on Electronic Commerce—Counsel to Commissioner

U.S. Multistate Tax Commission—Advisor, Multistate Tax Commission

State Government: District of Columbia—Member, D.C. Tax Revision Commission

Education

Rutgers College, B.A. political science

The Rutgers Business School, MBA

The Rutgers School of Law, Newark, J.D.

Georgetown University Law Center, LL.M.

- Focuses on tax planning, tax policy, and controversies for Fortune 500 clients.
- Strong experience in the corporate sector, having previously served as vice president and general tax counsel for MCI and as the president of Peracon, an electronic commerce company.
- An adjunct professor of law at the Georgetown University Law Center.
- Has a nationally recognized practice in the taxation of major corporations with particular experience in the taxation of digital goods, having spent over a decade working on technology, telecommunications, and electronic commerce matters, including as counsel to one of the commissioners of the U.S. Advisory Commission on Electronic Commerce and as an advisor to the Multistate Tax Commission.
- Named a D.C. Super Lawyer from 2012 - 2015, an honor reserved for five percent of practitioners.
- Has appeared in *The Washington Post*, *The Wall Street Journal*, FOX Business Channel and is the editor of two legal treatises.
- Has been invited to speak before the Congressional Internet Caucus, the IRS, the National Conference of State Tax Judges, the Congressional Chief of Staff Retreat, the Federation of Tax Administrators, the Multistate Tax Commission and numerous taxpayer organizations, bar associations and law schools.
- Has extensive experience handling federal securities law matters dealing with some of the largest mutual funds in the country.

Speaker – Robert Peters



Duff & Phelps, LLC

Managing Director, Tax Services

Education

New York University – MBA, finance

Stanford University – Executive MBA

University of Denver – B.S.,
accounting, *cum laude*

Certified Public Account

IL and NY

- Has 30+ years of experience providing state, local and federal tax services to corporate clients, ranging from Fortune 50 to emerging and mid cap companies.
- Specialization includes leading national unclaimed property, sales tax advisory, and compliance service areas.
- Assists companies in audit representation, voluntary disclosures, implementation of best practices and co/outsourcing of unclaimed property and sales tax compliance.
- Has been on the forefront of helping companies to effectively plan in the growing area of issuing stored value, gift card and consumer rebate programs, including working with states and industry leaders in addressing the unclaimed property issues resulting from such programs.
- Serves the consumer markets, retailers, manufacturing, public utilities, transportation, telecommunications, health care, media and financial services industries.
- A frequent speaker on unclaimed property and multi-state tax topics for many organizations, including Tax Executives Institute, Treasury Management Association, Financial Executives Institute, National Professional Unclaimed Property Organization, Chicago Tax Club and National Association of Credit Managers.
- Has been quoted in the *Wall Street Journal* and authored a series of articles on unclaimed property and state tax topics appearing in State Tax Notes, Forbes, Multi-State Taxation and Incentives, Financial Executives Magazine, BNA State Tax Report and Valuation Insights.
- Previous experience includes 29 years with KPMG, LLP as national partner in charge of state and local taxes, Midwest area tax risk advisory partner, unclaimed property leader and tax partner in charge of the Stamford office
- A prior chairman of the Ct. State Tax Committee, a committee member of the Illinois Tax Federation and he is on the Manufacturing Committee of the Unclaimed Property Professional Organization.

Speaker – David Ervin



Crowell & Moring LLP

Partner, Advertising & Product
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Government Experience

U.S. Government Accountability
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Education

American University, J.D. — *cum laude*
American University, B.A.
international relations — *cum laude*
with university honors

- Focuses on the relationship between advertising and intellectual property law.
- Provides counsel on current industry topics, including social media, gift cards and payment devices, branded content, native advertising, IoT and geo-location, fair use, and blogging.
- Clients include companies in the automotive, hospitality, wireless, retail, fashion, food & beverage, software, internet service providers (ISP), and financial services industries, as well as professional athletes, musicians, and sports leagues.
- Helps clients manage and protect their brands and IP rights in connection with their advertising, media, sponsorship, licensing, sports marketing, e-commerce, loyalty program, and joint promotion activities.
- Handles the negotiation and drafting of marketing, sponsorship, endorsement, and promotion agreements for advertisers and agencies with entertainment properties, broadcasters, publishers, athletes, models, celebrities, and professional sports leagues and teams (including the NFL, NASCAR, IndyCar, NBA, MLB, NHL, MLS, NCAA, and PBR).
- Assists clients with advertising production and media placement matters that involve music and content clearance, rights of publicity, SAG/AFTRA, claim substantiation, media barter, product placement, and new media issues.
- Recommended by *US Legal 500 2012-2014* for his work in the Marketing & Advertising area, and is listed as a leading lawyer in both *The International Who's Who of Sports & Entertainment Lawyers 2013 and 2014* and *The International Who's Who of Business Lawyers 2014*.

Overview of Stored Value Products

Overview of Stored Value Products

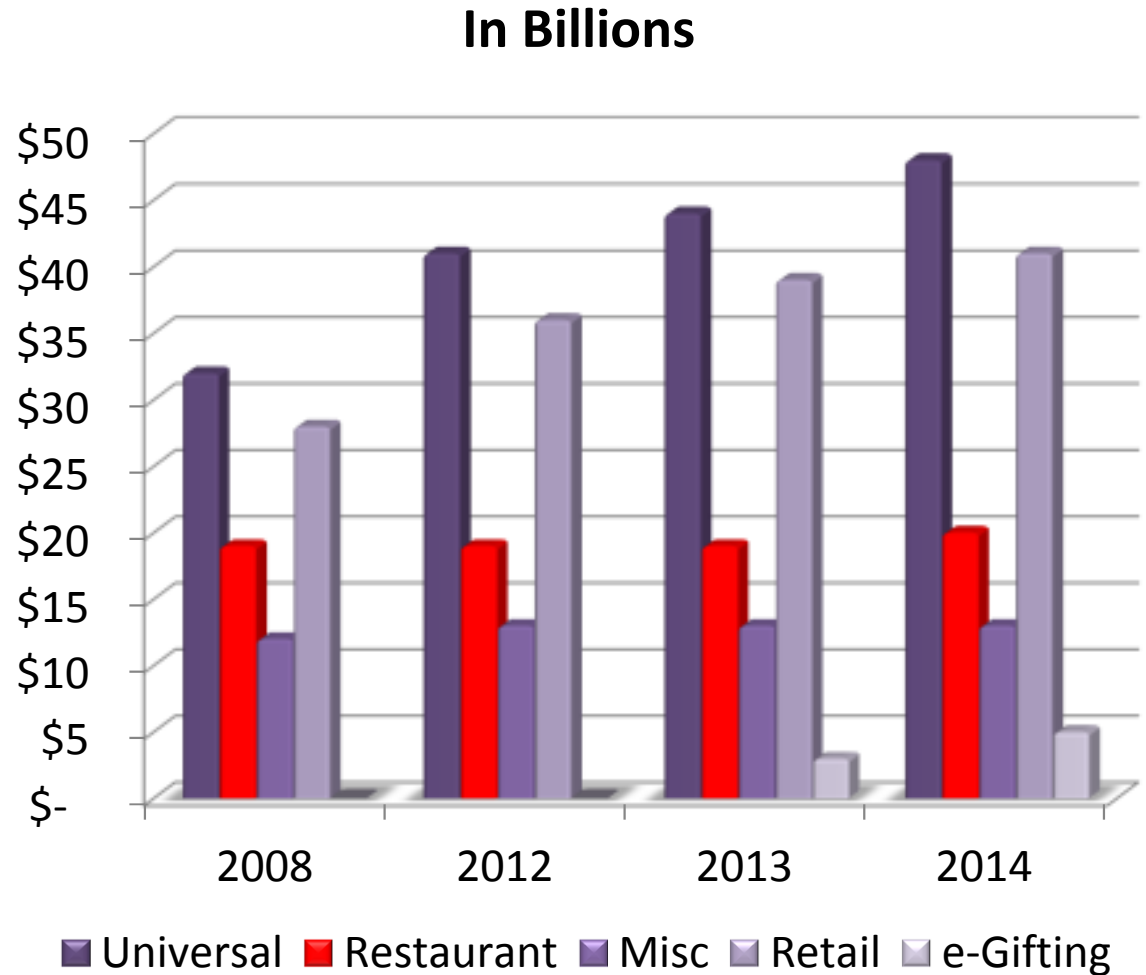
- Gift card products:
 - Open Loop Cards
 - Closed Loop Cards
- Loyalty, rewards, and promotional programs
 - “Free” member, points-based programs
 - Incentives/give-aways
 - Daily deals
- Other stored value products:
 - Mio Card and Bluebird account
 - Payment devices, virtual currencies, and more

Gift Card Products

- Open Loop Gift Cards:
 - Open system network like Visa or MasterCard
 - Redeemable at unlimited number of accepting merchants
 - Third party bank is the issuer – bank exempt from state money transmitter license requirements
- Closed Loop Gift Cards:
 - Closed system – single merchant or affiliated merchants
 - Merchant is the issuer
 - No money transmission, only redemption of goods & services
- Universal gift cards – 5 year term, reloadable, branded cards at stadiums, venues, colleges, etc.
- Heavily regulated industry – federal/state laws

Estimated U.S. Gift Card Spending, 2008-2014

- Growth peaked in 2012, Projected sales to reach \$150 billion in 2017, E Cards gaining ground

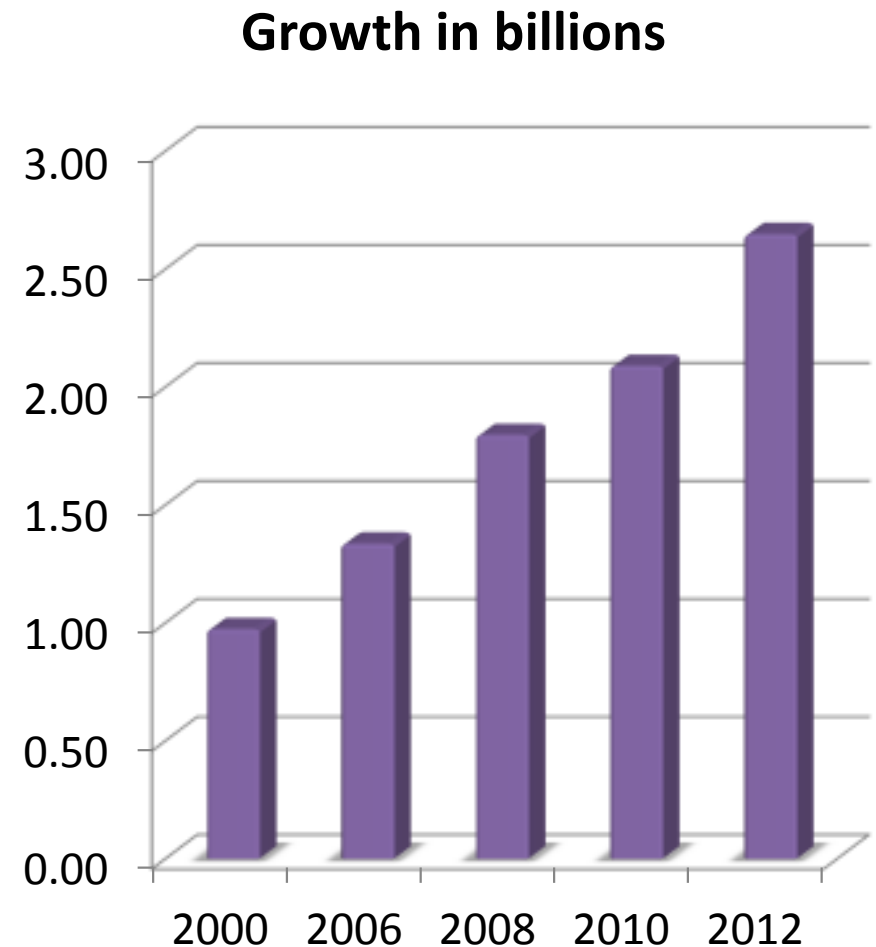


Loyalty, Rewards, and Promotional Programs

- Traditional rewards or loyalty program akin to rebate program – and generally less regulated than gift cards
 - Promotional nature: benefits provide incentive to remain loyal
 - Contractual reality: terms create consumer contract
- Promotional cards & free codes:
 - Short-term, campaign driven and low face value
 - Frequently used for customer acquisition and events
- Daily Deals and hybrid promotional offers: \$20 for \$40
 - Paid value: pre-paid, voucher-based for merchant
 - Promotional value: limited period discount at merchant

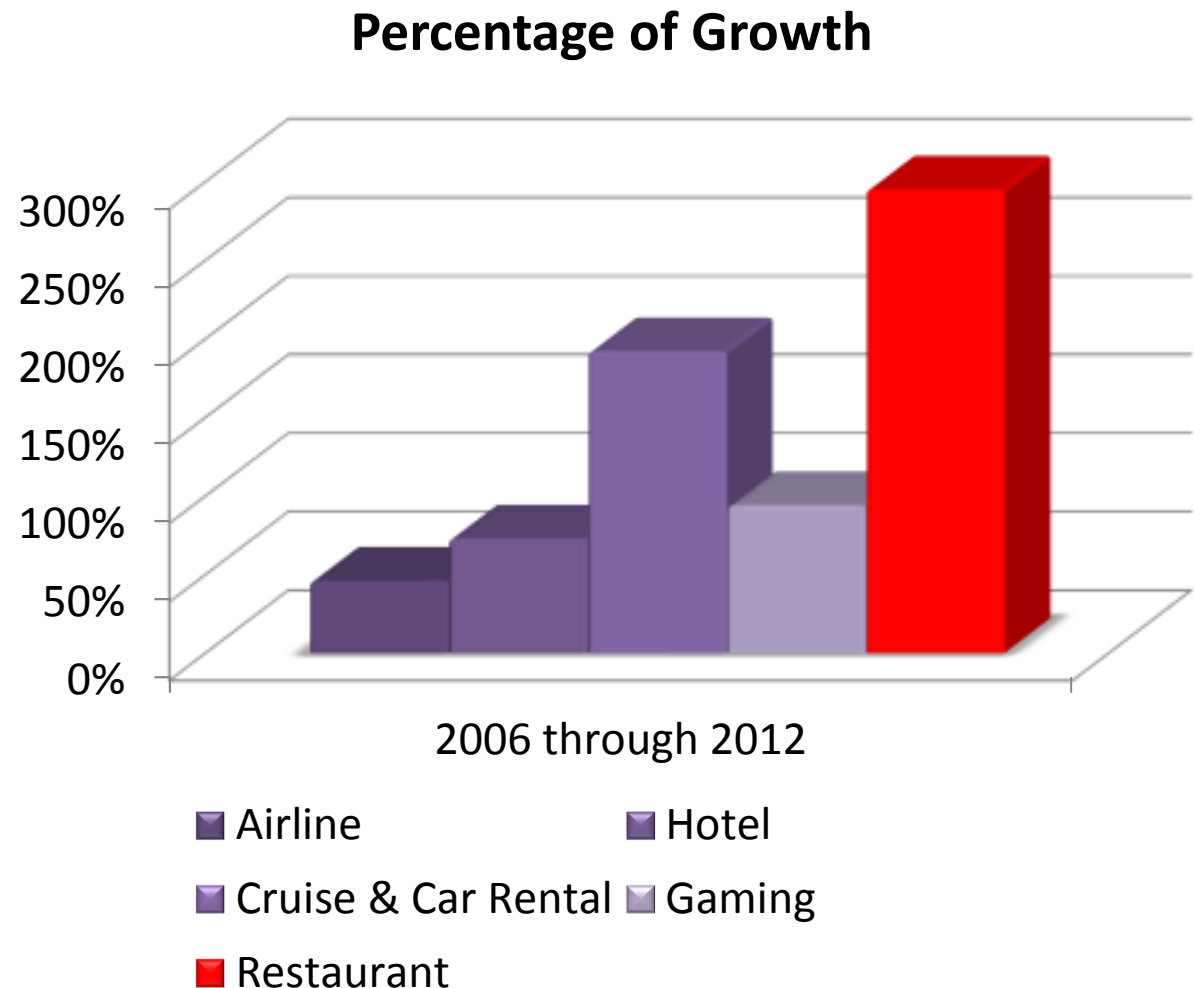
U.S. Loyalty Program Memberships, 2000-2012

- Since 2000, average growth is about 8.7% compounded
- Repeat customers spend 67% more than a new customer
- Average adult is enrolled in 18 programs, active in only 5-7
- 70% of Millennials wouldn't be loyal to a company without rewards program
- 61% of retailers use Loyalty Programs



Loyalty Program Segment Growth, 2006-2012

- The Restaurant industry experienced explosive growth; 295% over the period 2006 through 2012



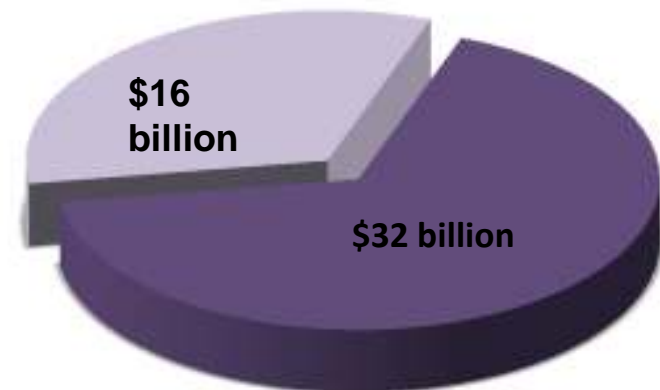
Explosive Growth of Rewards Programs

- Americans earned approximately \$48 billion in frequent flyer miles, hotel rewards, credit card points and other loyalty program currency just in 2011 alone. ¹
- Of the value earned in 2011, nearly 33% or \$16 billion went unredeemed. ²
- There were 2.6 billion rewards/loyalty program memberships in the U.S. in 2013, an increase of 26.7% from 2012. ³
- Customers loyal to a single retailer can generate up to 55% - 70% of the company's sales. ⁴

^{1,2,3} Source: Colloquy

⁴ Source: CRM at Northwestern University

**Loyalty/Reward Points
Earned and Redeemed in
2011**



■ Redeemed in 2011

■ Unredeemed in 2011

Other Stored Value Products

- Prepaid, reloadable cards:
 - Mio Card → MyVanilla Card
 - Green Dot Card
 - Issuers like InComm are licensed state money transmitters
 - Issuers like Green Dot Bank are actually banks
 - Use credit card payment networks like Visa and MasterCard
- Prepaid payment services and non-bank accounts:
 - AmEx Bluebird account: Benefits of banking without all the fees
 - AmEx Serve Card: cash reload, ATM access, online bill pay
 - Use AmEx network and retail partners like Walmart, CVS, etc.



Federal and State Gift Card Laws

Gift Card Overview

- Federal law sets the floor on consumer protection = minimum required
- State laws makes national gift card program nearly impossible to manage in full compliance; some states have more restrictive laws, some are conflicting
- The biggest issue = Escheatment of gift card breakage and impact on revenue and costs
 - Property is a state law issue and varies widely
 - *Delaware v. Card Compliant* case may change the whole game for many issuers

Federal Gift Card Law: What it Covers

- **The Credit Card Accountability Responsibility and Disclosure Act of 2009 (“CARD” Act):**
 - Does not preempt state gift card laws, except if state laws are inconsistent with the Act. Minimum level of gift card regulation
 - Applies broadly to gift cards, stored value cards, and general use prepaid cards
 - Exclusions: Loyalty, award, or promotional gift cards, plus
 - Gift cards used solely for telephone services;
 - Gift cards that are reloadable, not marketed or labeled as a GC;
 - Gift cards that are not marketed to the general public;
 - Gift certificates issued only in paper; or
 - Gift cards redeemable only for admission to events or venues at particular locations
 - CARD Act jurisdiction under Consumer Financial Protection Bureau (CFPB) per Dodd-Frank Act of 2010
 - No enforcement actions to date, but some rulemaking

Federal Gift Card Law: What is Required

- **No Expiration Dates less than 5 years**
- **Fees prohibited** unless no activity for 12 months
- Expiration and fees require **clear and conspicuous disclosures**
- **Mandatory disclosures** (toll-free number, URL, etc.)
- The Fed punted on preemption: inconsistent state laws still apply and create risks of enforcement for issuers
- Does not directly address escheatment, but prohibiting expiration before 5 years allows shorter state abandonment periods to apply to card balances
 - Breakage nationwide has reduced since 2010; overall redemption rates are higher (*CEB Towers Group 2014 Gift Card Executive Survey*)

Other Federal and State Laws That Apply

- FinCEN: limit daily load value to \$2,000 to maintain exemption from Money Services Businesses (MSB) registration and AML policy implementation under Bank Secrecy Act (BSA).
 - July 2011 Final Rule: Closed loop gift card issuers are providers of “Prepaid Access” under BSA
- Banking laws: Reg. E, Reg. Z, Truth-in-Lending, USA Patriot Act, etc. based upon deposit-based nature of cards, reloadable functionality and 3rd party payment features
- Privacy laws, including Calif. Song-Beverly Credit Card Act and similar laws in DE, DC, GA, KS, MD, MA, MN, NV, NJ, OH, OR, PA, RI and WI (restricts requests of PII)
 - Calif. Supermarket Club Card Disclosure Act – prohibits sale and disclosure of member personal information

State Gift Card Laws: Some General Trends

- Expiration prohibited: CA, CT, FL, IL, ME, MN, MT, NH, NJ, RI, WA
- Fees prohibited or limited: CA, CT, FL, HI, IL, LA, MA, MN, MT, NH, ND, NJ, NM, OR, RI, VT
- Cash redemption required: CA (<\$10); CO, ME, MA, MT, OR & WA (<\$5); RI & VT (<\$1)
- Excludes loyalty, promotional or charitable purpose: AZ, AR, CA, FL, GA, HI, IL, LA, MD, MA, MT, NV, NH, NJ, NM, ND, OH, OK, RI, TN, TX, VT, WA
- NY terms and conditions disclosure: required in writing at POS
- Escheatment standards for gift cards vary widely:
 - No exemption: AK, DE, MS, MO, NJ, NY
 - Exempt: AR, CO, CT, FL, IN, MD, MA, MN, NH, OH, UT, WY
 - Exempt if no expiration: CA, HI, IL, NE, NV, NC, PA, RI, SD, TN, VA, WA

Unclaimed Property Implications of Value Cards and Rewards Programs

State of Delaware ex rel. French v. Card Compliant, LLC, et al., N13C-06-289 (Superior Court of Delaware, New Castle)

The screenshot shows a news article on the Delaware Online website. The page header includes the logo for 'do delawareonline' and the text 'The News Journal A GANNETT COMPANY'. A navigation bar contains links for HOME, NEWS, SPORTS, LIFE, ENTERTAINMENT, TRAVEL, OPINION, OBITUARIES, and USA TODAY. The article title is 'Delaware joins suit alleging gift-card scheme'. The author is Jonathan Starkey, and the date is 8:53 p.m. EDT April 24, 2014. The sub-headline reads: 'Suit says firms deprived state of "hundreds of millions of dollars" in unclaimed property'. A photo of various gift cards is shown with the caption '(Photo: Getty Images)'. The main text states: 'The Delaware Department of Justice has joined a whistleblower lawsuit in Superior Court alleging that more than two dozen well-known corporations – including Netflix, California Pizza Kitchen and Shell Oil – schemed to deprive Delaware of "hundreds of millions of dollars" of unclaimed property revenue by not turning over the value of unredeemed gift card balances.' A 'STORY HIGHLIGHTS' section lists: 'Stuart Grant, the high-powered Wilmington lawyer, filed the case under seal in Superior Court in June 2013, on behalf of his...'. Social media sharing options for Facebook, Twitter, LinkedIn, Comment, Email, and More are visible.

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Delaware joins suit alleging gift-card scheme

Jonathan Starkey, The News Journal 8:53 p.m. EDT April 24, 2014

Suit says firms deprived state of "hundreds of millions of dollars" in unclaimed property

(Photo: Getty Images)

STORY HIGHLIGHTS

- Stuart Grant, the high-powered Wilmington lawyer, filed the case under seal in Superior Court in June 2013, on behalf of his

The Delaware Department of Justice has joined a whistleblower lawsuit in Superior Court alleging that more than two dozen well-known corporations – including Netflix, California Pizza Kitchen and Shell Oil – schemed to deprive Delaware of "hundreds of millions of dollars" of unclaimed property revenue by not turning over the value of unredeemed gift card balances.

Delaware's annual budget relies heavily on unclaimed property revenue from companies that make Delaware their legal home, which can include

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Unclaimed Property Laws: Inherent Conflict

Business Interests

Consumer Protection

State Revenues



Unclaimed Property Laws: The Basics

- All States have unclaimed property laws
- If the “owner” of the property has not used the property for an “abandonment period”, the “holder” of the property must pay the property to one of the States
- Abandonment periods vary for types of property, and by State, but usually **three to five years**
- The owner can reclaim the property from the State. Most States maintain databases online for the purpose
- Which State gets the property?
 - The United States Supreme Court held in *Texas v. New Jersey*:
 - The first priority State is the State of residence of the owner, as shown on the holder’s records
 - If there is no such record, or if the address is in a State which does not provide for the escheat of such property, the second priority State is the State of incorporation of the holder

Gift Cards: Unclaimed Property Guidelines

- **Derivative Rights Doctrine**
 - State’s rights to property are “derived” from rights of owners
 - Views differ over years regarding what “rights” state is entitled
- **Holder’s Advocates Argue**
 - Requirement that “funds” be remitted versus property exceeds common law definition
 - States have consistently overstepped authority when rights have expired under contract
 - Framers of UP laws never intended states to impose rules which infringe on consumer protection provisions which grant limited period of time for owners to claim amounts owed to them
- **State Administrators Argue**
 - Term does not mean “exactly” same rights as owners
 - Advocate “schemes” thwart true intent of the law and deprive owners rights to enjoy property
 - State rights exceed rights of holders, and of owners, particularly if “T & C” deprive owners of right to enjoy gift cards
 - Enactment of advocates definition would “emasculate” state unclaimed property program as applied to other forms of property

Are Unredeemed Gift Cards Unclaimed Property?

- **Approximately 30 states** have some form of exemption for “gift certificates” and/or gift cards
 - Often times, exemption dependent on certain conditions:
 - GCs cannot have expiration dates or fees (CT, ME, RI) others have requirements
 - GC’s must be below a certain dollar amount (VT, CO, ID, NH)
 - GC’s cannot be redeemable for cash
 - State may not define “gift certificate” or “gift card”
 - State may only exempt one, but not the other (*e.g.* CO)
 - Even if defined, inconsistent treatment of open-loop, versus closed loop cards, promotional loyalty or rewards card

If Cards are Escheatable, What Amount is Treated as Unclaimed Property?

- 1981 Uniform Act: “price paid” for gift certificate
- 1995 Uniform Act 60% of face value
- Delaware allows retailer to keep their profit margin and escheat only cost of goods sold
- If GCs have fees, may be deductible if:
 - Imposed pursuant to valid and enforceable written contract,
 - Charges are not regularly waived and
 - Charges are not unconscionable

What Can Be Done to Minimize Escheat?

Restructuring must address the Priority Rules

- **First priority rule:** Often a concern if GCs sold online or with rewards/loyalty programs
- **Second priority rule:** The holder can be domiciled in a state that has favorable unclaimed property rule for GC's
 - **Redomestication vs. SPE (Giftco) vs. third party**
- **Third priority rule:** Strong argument that this rule is unconstitutional, but sometimes restructurings can be designed to avoid the rule altogether

Consumer Protection Enforcement Trends

Consumer Protection: Enforcement Trends

- Deceptive and unfair trade practices claims widely used in class actions
 - Federal: Lanham Act
 - State: UDAP laws
- Consumer fraud: CLRA and more state laws
- Warranty and rebate state laws
- Breach of contract and implied duty of good faith and fair dealing

Early Cases: Frequent Flyer Programs

- *Wolens v. American Airlines*, 513 U.S. 219 (1995) – class action filed after program benefits structure changed in 1988; state Consumer Fraud Act claims preempted but breach of contract survives
- *Grossman v. USAir, Inc.* (Pa. 1997) – airline allowed to increase number of miles required because clear reservation of rights in program terms (and right to terminate)
- *Monzingo v. Alaska Air Group, Inc.* (Alaska 2005) – modification of awards allowed because reservation of rights to terminate program

Unfair Competition: Recent Class Actions

- *Fafard v. Apple Inc. et al.* (N.D. Cal. 2014): settled claims under Cal. Unfair Competition Law and CLRA for deactivation of iTunes gift cards without disclosure
- *L. S. v. Webloyalty.com Inc. et al.* (D. Conn 2014): claims under Conn. unfair competition laws for rewards program that caused monthly credit card charges. Motions to dismiss pending
- *Motwani v. Marina District Dev. Co.* (N.J. Super. Ct., Bergen County 2015): challenge to rewards program parking voucher restrictions under N.J. Consumer Fraud Act. Complaint filed Jan. 2015

Rewards Programs Under Attack: The Risks of Revising Program Terms

- *Kwok v. Delta Air Lines Inc.* (11th Cir. 2014): challenge to rewards earn formula modification under breach of contract dismissed
- *Gordon v. United Continental Holdings Inc. et al.* (D.N.J. 2014): claims under N.J. Consumer Fraud Act and Truth-In-Consumer Contract, Warranty and Notice Act for charging members with higher account balance more miles for redemption of rewards. Dismissal under preemption
- *Sateriale v. R.J. Reynolds Tobacco Co.* (C.D. Cal. 2009): breach of contract claims for eliminating merchandise options for redemption of “Camel Cash” reward program. State class certified in Dec. 2014

Loyalty, Rewards, and Promotional Programs

- Promotional programs with paid value element: Daily Deals
 - Lessons from Groupon MDL (S.D. Cal. 2012) and LivingSocial MDL (D.D.C. 2013) class action settlements
 - Paid portion – trend to never expire, but need at least 5 years before
 - Promotional portion – can expire with proper notice
 - Only 10% with expiration dates of 30 days or less
 - Redemption rates are critical to risk assessment
 - Pre-paid stored value plus coupon offer = hybrid product

Current Landscape

Unclaimed Property Recent Development

New Jersey

Full Circle Treatment of Gift Cards:

- Prior to 2010 Gift Cards were not subject to State unclaimed property rules based on common law
- 2010 sweeping legislation enacted to treat unredeemed gift cards as unclaimed property
 - If unredeemed after 2 years
 - Required seller to collect address information, minimum zip code
 - “Place of Purchase Presumption” used to source to New Jersey if card was sold in NJ and no address information was available
 - Law applied retroactively to any card that was outstanding
- Early 2012 Federal Court held place of purchase presumption invalid and retroactive application unconstitutional, unresolved was zip code collection requirement
- July, 2012 Legislature alters rules:
 - Provides 5 year abandonment period
 - Prohibition on Fees and Expiration Dates
 - Disclosure Requirements
 - Zip Code delayed
- 2014 Zip Code Requirement Eliminated

Unclaimed Property Recent Development

QuiTam Whistleblower Complaint

Action brought under Delaware False Claims Act against 30+ retailers alleging:

- The Card Services Defendant “CSD” helped other Delaware “named defendants” to avert having to report unredeemed gift card balances to the State of Delaware
- Defendants have schemed to deprive the State of Delaware of hundreds of millions of dollars due to the State under Unclaimed Property Laws
- CSD conspired with the Delaware Defendants to hide revenue from the state by creating sham contracts portraying themselves as “holders” of unredeemed gift cards in exchange for a fee
- To facilitate the scheme, the CSD set up shell corporations to “allegedly hold” the value of unredeemed gift cards. Ohio and Florida do not escheat gift cards.
- CSD created phony relationships with the Delaware Defendants whereby gift cards redeemable for products and services sold by the Delaware Defendants were “issued” by the Ohio and Florida corporations.
- CSD promised Delaware Defendants that they would not have to:
 - Change Anything about the way they conducted their gift card business and
 - They could keep the “breakage” on the unredeemed gift cards at all times

The State of Delaware and William Sean French, Plaintiff-Relator v. Named Defendants pursuant to Delaware False Claims and Reporting Act, 6Del. C. §1203(b)(2) and Superior Court Civil Rules 4&5

Unclaimed Property Recent Development

QuiTam Whistleblower Complaint (Defendant Actions)

Action to remove the case from the Delaware state court to the Federal District Court asserting

- Claims asserted for alleged violation of Delaware False Claims Act depend on resolution of disputed questions under federal common law established in chain of Supreme Court cases
- Under Supreme Court decisions the debtor's state of incorporation has priority claim over the unredeemed card balances
- Debtor in this case is "issuer" of the card, CSD, not Delaware Defendants who retain the funds but not the obligation to satisfy the card owners
- Raises the challenge whether under Federal law the –outstanding balances on gift cards are a "debt" actually subject to the unclaimed property laws. **Derivative rights** argument, that promise only to pay "goods and services" not redeemable for cash
- Raises for first time, application of the second priority right to LLC's vs. "corporations" as stated in Supreme Court Decisions
- Most states have adopted second priority state for **LLC** based on Uniform Unclaimed property provisions for non-corporate entity as the State of that entity's **principle place of business**
- Thus Delaware Defendants with LLC's with principal place of business outside of Delaware would not be subject to Delaware's False Claims Act

Motion Filed by Defendants to Change Venue of Case from Delaware to Federal Court Denied

(*Texas v. New Jersey*, 379 U.S. 674 (a965), *Pennsylvania v. New York*, 407 U.S. 206 (1972), and *Delaware v. New York*, 507 U.S. 490, 498 (1993))

Unclaimed Property Recent Development

QuiTam Whistleblower Complaint Key Take Aways

- Audits of both Captive Gift Card Companies and Third Party Providers such as Card Compliant which began before QuiTam Action are likely to continue or increase
- Action likely to continue for extended period of time (will take years to resolve)
- Companies should focus on both the “economic substance” of entities and transactions in addition to legal form
- Prior planning and existing structure of all gift card activities should be revisited in light both existing Qui Tam action AND increased audit activity by Delaware, and other jurisdictions
- Look for other Qui Tam actions to be initiated in future unclaimed property matters by parties of interest (eg employees, customers, states) beyond Gift Cards

Other Recent Developments of Interest

- **Delaware legislation** extended the Voluntary Disclosure program to September, 2014 with completion date of June, 2016. Similarly, extends date for those already entered into program after June, 2013 until June, 2016
- **Litigation also pending** which further challenges use of “estimation and extrapolation” techniques, *Temple-Inland, Inc. v. State of Delaware*, in Federal District Court. Motion to change venue to Federal Court was approved, case to be heard in Jan., 2016
- **Uniform Unclaimed Property Act is being redrafted**, among the issues to be addressed is treatment of “gift cards” and similar items
- State audits of gift cards are increasingly focused on linkage between rewards programs and “known address” of cardholders
- Rewards/loyalty programs, currently not subject to unclaimed property, but could be if Federal Card Act requirements are not satisfied

Caveats to Reliance on Federal Card Act for Unclaimed Property Purposes

- Unclaimed Property Laws have not kept pace with new card offerings
- Many states require that cards have no expiration date, nor any inactivity fees in order to exempt from reporting as unclaimed property
- Failure to meet the disclosure requirements will result in reward, loyalty card being considered “gift card”
- If redeemable for cash, many states will **NOT** exempt from unclaimed property provisions (even those states that may otherwise exempt gift cards from reporting)
- If “consideration” is paid for card, even if under a loyalty program, many states will treat as subject to unclaimed property provisions
- Despite “derivative rights doctrine”, Broad authority under “other property” catch all unclaimed property provisions

Planning Considerations

Virtual Currencies

- Growth out pacing use of gift cards or coupons. Estimate to be worth in excess of \$50 billion at end of 2014
- Comes in many forms, *“receipt of something of value not backed by currency”*:
 - Retail loyalty points
 - Air miles
 - Coupons
 - Game based virtual currency
 - Bitcoins
- Unclaimed property rules trail product and service offerings
- Potential to be treated as “stored value card” or “electronic gift certificate” if:
 - Consideration is paid for “virtual” currency
 - Virtual currency is redeemable for cash or cash equivalent
 - Does not qualify under Federal Card Act as a Loyalty, Rewards Offering
- Stakes are high, non-compliance with Federal card act and state unclaimed property provisions can result in significant liabilities, penalties, class action law suits and adverse publicity

Rewards Programs Risk: Imputed Stored Value

- Factors which **increase risk** that “free” brand loyalty and rewards programs deemed to include stored value:
 - Multiple redemption partners, including gift cards
 - Transferability of value to third party merchants
 - Purchase of rewards points = cash payment
 - Treatment of points as currency, especially across platforms
 - Cash back as redemption option
- Factors which **mitigate against risk** that programs being treated as “stored value card” or “electronic gift certificate”:
 - Members typically do not pay something of value to earn points
 - Redemption of points to non-expiring benefit
 - High redemption rates keep potential breakage lower

Key Take Aways

- Additional regulation by states and now federal authorities is likely only going to increase level of complexity in accounting for gift card, reward and loyalty programs
- Stakes are high, non-compliance with Federal card act and state unclaimed property provisions can result in significant liabilities, penalties, class action law suits and adverse publicity
- Reliance on Federal Card Act exceptions will not necessarily apply to more stringent state unclaimed property provisions
- Inclusion of expiration dates increases risks on both fronts
- Planning and careful review of all levels is critical including federal regulatory, income tax, unclaimed property and state income/sales tax implications
- Expect proliferation of new products and services to proceed at a different pace than laws and regulations

Questions?

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