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THE FRANCHISE LAWYER

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New Federal Gift Card Regulations to Become Effective on August 22, 2010

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On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 ("Credit CARD Act") was signed into law by President Obama. The Credit CARD Act amends the Electronic Fund Transfer Act ("EFT Act") by adding federal regulations applicable to "gift certificates," "store gift cards," and "general-use prepaid cards" (collectively, "Gift Cards"). Specifically, a person is prohibited from imposing expiration dates or dormancy, inactivity or service charges which do not comply with the conditions of the new federal gift card regulations. To implement the new federal gift card regulations, the Board of Governors of the Federal Reserve System ("Board") announced on March 23, 2010, following a notice and comment period, an amendment to Regulation E and the official staff commentary to Regulation E ("Gift Card Regulations"). Pursuant to the Credit CARD Act, the Gift Card Regulations become effective on August 22, 2010. This article will highlight the important provisions of the Gift Card Regulations to help franchisors and franchisees with gift card programs prepare for the new law.

Effect of Gift Card Regulations on State Gift Card Laws

One of the Credit CARD Act amendments to the EFT Act provides that the EFT Act will not preempt state laws which provide greater protection than the Gift Card Regulations. As such, the new federal minimum standard under the Gift Card Regulations for expiration dates and dormancy, inactivity and service charges will be the only regulations in the approximately ten states without gift card regulations. For the remainder of the states, the impact of the Gift Card Regulations will depend on the extent the state law focuses on the required disclosures, the fees that can be charged in a given month and the amount of inactivity required before service fees can be charged.

Gift Card Definitions

Under the Gift Card Regulations, 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 which can be redeemed for goods and services at a single merchant or an affiliated group of merchants. An "affiliated group of merchants" is two or more affiliated merchants or persons related by common ownership or corporate control which share the same name, mark or logo. For example, the term includes franchisees that are subject to a common set of corporate policies or practices pursuant to their franchise agreements. Unless excluded under the Gift Card Regulations, closed-loop cards are generally considered to be "gift certificates" or "store gift cards."

A "general-use prepaid card" is essentially the same as a "store gift card," except that it can be redeemed for

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goods and services at multiple unaffiliated merchants or used at ATMs. Unless excluded under the Gift Card Regulations, open-loop cards are generally considered to be “general-use prepaid cards.” One common example of general-use prepaid cards are “open-loop” cards issued by banks which can be used at any retailer that accepts that card brand (i.e. Visa or MasterCard).

A “gift certificate” is basically a “store gift card,” except that a gift certificate’s value cannot be increased or reloaded.

Dormancy, Inactivity and Service Fee Restrictions and Related Disclosure Requirements

Under the Gift Card Regulations, it is unlawful to impose dormancy, inactivity or service fees on Gift Cards unless three conditions are satisfied. First, there must not be activity on the card or certificate during the one year period before the fee is imposed. As such, if a fee is imposed after a one year period with no activity and the consumer uses the card or certificate the following month, another fee cannot be imposed until another year of inactivity passes. 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). Second, only one dormancy, inactivity or service fee can be imposed in any given calendar month. For example, if such a fee is imposed on February 24th, the next such fee could not be imposed until March 1st at the earliest. Finally, dormancy, inactivity and service fees must be disclosed “clearly and conspicuously” on the card or certificate *and* the issuer or vendor must provide such disclosures to the consumer prior to purchase.

The Gift Card Regulations contain a complex array of disclosure requirements applicable to various settings depending on, for example, whether a consumer purchases an instrument such as a card, code, or device in person or whether a Gift Card is purchased over the telephone. Certain disclosures are required on the face of a card and others can be made on packaging, electronically or orally. Additionally, certain disclosures made on accompanying contract documents do not comply with the clear and conspicuous disclosure requirements.

For purposes of the Gift Card Regulations, “dormancy fees” and “inactivity fees” are fees for the non-use of or inactivity on a Gift Card. “Service fees” are periodic fees for holding or use of a Gift Card and include monthly maintenance fees, transaction fees, reload fees or balance inquiry fees (it does not matter if the fee is waived or only assessed after a certain period of time). Although the Board is clear that “service fees” will be interpreted broadly, service fees do not include certain one time fees such as issuance fees or cash-out fees.

The following is summary of certain important disclosure requirements:

- Dormancy, inactivity and service fees must 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.
- A toll-free phone number and web address, if one is maintained, where consumers may obtain fee information or a replacement Gift Card must be disclosed.
- Information regarding whether funds underlying a Gift Card may expire must be disclosed on the Gift Card.
- Electronic disclosures cannot be given through a hyperlink or in a manner where the purchaser can easily bypass the disclosure.
- In situations where oral disclosures are allowed, written or electronic disclosures must still be given on or with the Gift Card.

An issue that has caused confusion regarding disclosures on loyalty, award, and promotions cards, which are generally excluded from coverage under the Gift Card Regulations, is the fact that the substantive restrictions regarding the timing of service fees and expiration dates do not apply; but the terms of any service fees—to the extent such fees exist—must be disclosed in equal prominence and in close proximity to the card

expiration date.

Expiration Date Restrictions

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). In certain instances, the expiration date for the underlying funds can be different from the printed expiration date on the card (i.e. a consumer could load additional funds on a card with a printed expiration date that is less than five years after the date such funds are loaded). Concerned about the possibility of consumer confusion regarding differences between the expiration date for the Gift Card and the expiration date for the underlying funds, the Board adopted an approach to ensure that consumers will have an adequate period of time to spend Gift Card funds. The Board's approach provides that 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. In the official staff commentary, the Board explains 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 (i) policies and procedures are in place to prevent the sale of a Gift Card that does not have an expiration date at least five years after the date the Gift Card was sold or initially issued to a consumer; or (ii) a Gift Card is available to consumers to purchase five years and six months before the Gift Card expiration date.

Exclusions

The 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:

1. Cards usable solely for telephone services;
2. Reloadable cards not marketed or labeled as a Gift Card;
3. Loyalty, award, or promotional gift cards;
4. Cards not marketed to the general public;
5. Cards issued in paper form only; and
6. Cards redeemable solely for admission to events or venues.

For those who wish to claim an exclusion, a careful and thorough review of the Gift Card Regulations is necessary to ensure that appropriate steps are taken to fall within the desired exclusion.

Applicability and Potential Impact on Franchisors and Franchisees

The Gift Card Regulations apply to issuers and sellers of Gift Cards. Since franchisors typically establish and control a franchise system's gift card program and franchisees sell Gift Cards to consumers, the Gift Card Regulations likely apply to both franchisors and franchisees. The following is a list of items franchisors and franchisees should consider and be aware of in advance of August 22, 2010 when the Gift Card Regulations become effective:

- Franchisors should carefully evaluate the differences between the Gift Card Regulations and the myriad of state regulations governing Gift Cards because many state regulations provide greater protection to consumers. For instance, many state laws require issuers of unused gift cards (or cards with unused balances) to transfer, or escheat, to the state where the cardholder resides or the issuer is incorporated, any remaining funds after a certain period of time. 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. Unfortunately, the preemption language in the Gift Card Regulations does not clearly address this issue. Thus, it can be argued that issuers are obligated to transfer unspent funds to certain states after three years while simultaneously maintaining adequate funds to cover the five year expiration period required by the Gift Card Regulations. Because state escheat laws vary, the Board believed 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 such a law is inconsistent with the Gift Card Regulations. In such a scenario, the Board's analysis would be published for notice and comment, and, if the Board determined that the state law is preempted, the final determination would be published in the commentary. Franchisors should be prepared to address this potential issue.

- Franchisors should start thinking about additional policies and procedures that may be required for its gift card program, and determine whether franchisees will need additional training to ensure compliance with the Gift Card Regulations. For example, franchisors should anticipate establishing sales and marketing procedures to ensure that cards will not be sold with a stated expiration date that does not comply with the Gift Card Regulations.
- Franchisors and franchisees 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, a Visa, MasterCard or other logo, state-specific consumer protection disclosures, and the card number. The Gift Card Regulations include many specific requirements on what must be included on the gift card, and how such information can be displayed. As such, franchisors should consult the regulations to get a head start on preparing new Gift Cards which comply with the new regulations.
- If a franchisee sells 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 obviate the likelihood of any confusion regarding whether the cards are Gift Cards. For example, such cards should be presented in a display which does not include Gift Cards. Franchisees should also be prepared to answer questions from customers about the new disclosures under the Gift Card Regulations. It is important that franchisees review their Gift Card inventories and take steps to ensure that Gift Cards sold to customers comply with the Gift Card Regulations. Finally, franchisees should anticipate receiving new policies and procedures from franchisors about the Gift Card Regulations and could consider using the new regulations as an opportunity to talk to the franchisor about best practices for selling and marketing Gift Cards to customers.
- The Gift Card Regulations are available online [here](#).

Conclusion

The Gift Card Regulations establish a “federal floor” with respect to expiration dates and dormancy, inactivity and service fees. Since state laws that provide greater protection are not preempted by the new federal regulations, establishing and operating a legally compliant gift card program will continue to be a challenging task.

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