

# HOSPITALITY ALERT

## FEDERAL RESERVE ISSUES FINAL GIFT CARD REGULATIONS — DOES THE FEDERAL CARD ACT NOW PREEMPT CALIFORNIA STATE LAW?

On March 23, 2010, the Federal Reserve Board of Governors issued their final regulations implementing the gift card provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the “CARD Act”).<sup>i</sup> California hotels, restaurants, and other retailers, who are already complying with California’s gift card law<sup>ii</sup>, will also have to comply with these new federal laws by August 22, 2010.

### *Existing California Gift Card Law*

Under current California law, most gift certificates and gift cards sold by California merchants for use with the merchant (or any of its affiliates) may not contain an expiration date or impose a service fee, including any fee for inactivity.<sup>iii</sup> Gift certificates and gift cards sold in the State are redeemable by the consumer for their cash value OR subject to replacement with a new gift certificate or gift card at no cost to the consumer.<sup>iv</sup> In addition, gift certificates with a cash value of less than \$10.00 that were sold in California or presented by a California resident must be redeemed in cash upon demand by the consumer.<sup>v</sup>

But, California exempts some gift cards from these rules. For example, the law specifically exempts from regulation gift cards: (1) issued without charge pursuant to an awards or loyalty program; (2) donated or sold to non-profit organizations for charitable fundraising purposes; and (3) issued for perishable food products.<sup>vi</sup> In addition, unaffiliated, multiple-seller cards such as mall gift cards (for use in any store within the mall) and bank-issued gift cards (a Visa® gift card for use in any number of different stores) are also unregulated by California law.<sup>vii</sup>

But these are very narrow exemptions. In general, the overwhelming majority of gift cards sold in California are regulated by California’s strict, pro-consumer gift card law.

### *The CARD Act and Its Final Regulations*

In May 2009, as the recession deepened and consumer anger towards banks and credit card companies intensified, Congress passed the CARD Act. The CARD Act was and is primarily a bill aimed at curtailing abusive credit card practices by card-issuing banks. However, tucked into the CARD Act are several specific regulations aimed at gift certificates, gift cards, and “general-use prepaid cards.” These regulations became final on March 23, 2010.

Under the CARD Act’s final regulations<sup>viii</sup>, gift certificates, gift cards, and general-use prepaid cards may not impose dormancy, inactivity, or other service fees unless: (1) those fees are clearly and conspicuously disclosed on the certificate or card prior to purchase; (2) no more than one fee is charged in any calendar month; and (3) the card has been inactive for over 12 months prior to the imposition of the fee. If there are any other fees (such as initial issuance fees or cash-out fees) imposed, those fees must be disclosed on or with the card or certificate.

In addition, the CARD Act’s final regulations prohibit all expiration dates except for those that are 5 years or more from the date of issuance (for a gift certificate) or 5 years from the date of the last load of funds (for a store gift card or general-use prepaid card), and then only when the expiration terms are clearly and conspicuously disclosed to the consumer on the card or certificate in advance of purchase. In addition, if there is a difference between the certificate or card expiration date and the funds expiration date, the

final regulations require a disclosure: (1) alerting consumers to that difference, and (2) informing consumers of their right to contact the issuer for a replacement card or certificate.

The CARD Act's final regulations also prohibit the imposition of any fees for replacing any expired certificate or card if the underlying funds remain valid. This ensures that consumers are able to access the underlying funds for the full 5 year period. However, in lieu of sending a replacement certificate or card, the final regulations allow issuers to remit the remaining balance without charge to the consumer.

Finally, on all cards and certificates subject to the CARD Act, the final regulations require disclosure of a toll-free telephone number and a website (if maintained by the issuer) that a consumer may use to obtain information about fees and/or replacement certificates or cards.

### *Gift Cards Exempted Under The Card Act*

Like the California law, the federal CARD Act also exempts certain gift cards and/or certificates from these rules, including those that are reloadable and not marketed or labeled as a "gift card" or "gift certificate." Such gift cards or certificates are exempt from regulation under the CARD Act and, therefore, may contain expiration dates and/or impose inactivity or other service fees. In addition, gift cards that are issued in connection with "loyalty, award, or promotional programs" are also generally exempt from the CARD Act's requirements. However, under the final regulations, such cards must state on the front of the card that it is issued for "loyalty, award, or promotional purposes" and must as well state any funds expiration date that may apply. If fees are or may be imposed, those fees must be disclosed on or with the loyalty, award, or promotional gift card or certificate.

### *Impact on California Retailers*

The gift card provisions of the CARD Act, as well as its final regulations, go into effect nationwide on August 22, 2010. Once effective, the CARD Act will preempt any existing state gift card law that offers less consumer protection.<sup>ix</sup>

Because the CARD Act specifically preempts existing state laws that offer less consumer protection, retailers in California have to analyze the CARD Act and its final regulations and compare those consumer protections to

those contained in California's gift card law. Where California's gift card law is more protective of the consumer than the CARD Act (e.g., on expiration dates which are prohibited without exception under California law; on the requirement that consumers be allowed to demand cash redemption for cards with a value/balance less than \$10; and on reloadable cards which are not exempted under California law), then California state law will govern on those issues. Conversely, on any issue where the CARD Act offers more consumer protection than existing California law (e.g., by imposing fee disclosure and other restrictions on awards, loyalty, or promotional program cards which are missing under California law; and by regulating general use prepaid cards which are specifically exempted under California law), then the CARD Act will be the governing law in California on that issue.

Obviously, this is a challenging analysis because of the many issues that are covered in both laws. Moreover, because many gift cards are bought and used in different states, there may be an additional conflict-of-laws analysis that must first take place in order to determine what state law to use when making the CARD Act comparison. For example, for a California merchant selling a gift card to a consumer in Texas via the internet, it could be that Texas law applies. Thus, the federal CARD Act protections might have to be compared to any similar protections under Texas state law, not California law.

### *Suggestions for California Retailers*

We strongly encourage all California merchants with a gift card program to promptly: (1) review the rules of their gift card program, and (2) conduct a compliance audit to ensure those rules comport with the relevant, controlling law.

From now until August 22, 2010, the only relevant law is California state law. California merchants therefore want to ensure that, if their gift cards are subject to that law, no expiration dates are included and that no inactivity or other service fees are imposed. California merchants also want to ensure that they redeem for cash any gift card with a cash value of less than \$10.00 that is presented for redemption.

After August 22, 2010, California merchants will have to consider their gift card program in light of the CARD Act and its final regulations, and then compare that to the California state gift card law. On most issues, California state law will govern because that law is

generally more protective of consumers than the federal CARD Act and its current regulations. So for most California merchants, they will not need to make any changes to their gift card program on August 22, 2010. They simply continue to follow California law.

But that conclusion assumes that there are no changes to the CARD Act and its regulations, or California's gift card law and its regulations, between now and the date the audit begins. If California law is changed between now and then so that it becomes less protective than the CARD Act, then California law would no longer govern. Similarly, if the CARD Act's current regulations are amended so that they become more protective than California state law, then California merchants will have to follow the CARD Act and its regulations rather than California state law.

Finally, as courts weigh in with their interpretation of California's state gift card law or the federal CARD Act and its regulations, that too could change the analysis.

To make certain that this complicated federal vs. state law analysis is done correctly, we encourage California merchants to retain experienced California counsel whenever they are ready to begin their gift card program audits.

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<sup>i</sup> See Pub. L. 111-24, codified at 15 U.S.C. §1693 et seq.

<sup>ii</sup> See Cal. Civ. Code §1749.5 et seq.

<sup>iii</sup> Under certain limited circumstances, even gift cards and gift certificates that are regulated by the law can impose a service fee. But five strict conditions must be met, and many gift card and gift certificate programs will fail this test. See Cal. Civ. Code §1749.5(e).

<sup>iv</sup> See Cal. Civ. Code §1749.5(b) (1).

<sup>v</sup> See Cal. Civ. Code §1749.5(b) (2).

<sup>vi</sup> See Cal. Civ. Code §1749.5(d) (1)-(3).

<sup>vii</sup> See Cal. Civ. Code §1749.45.

<sup>viii</sup> See 12 C.F.R. Part 205 (Regulation E, Docket No. R-1377).

<sup>ix</sup> See 15 U.S.C. §1693(q).