Gift Card Issuers Traverse Shifting Legal Terrain:
Recent Developments in Gift Card Litigation and Legislation

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As the popularity of gift cards as a lucrative marketing tool continues to increase, so does legal scrutiny of gift card practices. The National Retail Foundation estimates that consumers spent $24.9 billion on gift cards during the 2008 holiday season (down from $26.3 billion in 2007). *See* http://nrf.com/modules.php?name=News&op=viewlive&sp_id=604. Recent developments, both on the state legislative front and in the courts, highlight the importance of legal review and oversight of gift card programs, especially during these uncertain economic times. Many states have enacted laws that impose new restrictions on how gift cards may be sold and honored, as well as what gift card issuers must do with unredeemed balances on gift cards. Thus, it is imperative that legal review of gift card programs continue beyond the implementation stage through the active tenure of the programs as gift card laws and interpretations thereof quickly evolve. The following recent legal developments highlight the uncertain and ever-evolving legal terrain gift card issuers face.

Recent case challenges gift card that is co-branded with federally regulated credit card company under New York law.

Lonner v Simon Prop. Group, Inc., 2008 NY Slip Op 07877 (App. Div. 2d Dep't Oct. 14, 2008)

In *Lonner v Simon Prop. Group, Inc.*, a New York appellate court upheld the denial of a motion to dismiss purported class claims against Simon Property Group, Inc. ("Simon") for breach of contract and deceptive trade practices. The lead plaintiff alleges that Simon, a gift card distributor, imposed insufficiently disclosed dormancy fees on the gift cards. (Dormancy fees are imposed against the card balance after a specified period of non-use.) The gift cards at issue were prepaid cards that worked like debit cards Bank of America issued through a license from Visa.

The lead plaintiff contends that the imposition of the fees constitutes a breach of contract and a deceptive trade practice. Simon imposed a $2.50 dormancy fee per month in the seventh month after purchase of the gift card. The fee was disclosed in small print on the back of the card and in the card's terms and conditions included in a booklet attached to the cardboard packaging for the card. New York Civil Practice Rule Section 4544 provides that a consumer contract in which the print is not clear and legible or is less than eight points in size (five points for upper case) may not be accepted as evidence on behalf of the party who prepared the contract.

The lower court had previously dismissed the claims on federal preemption grounds because Simon's gift card program was co-branded with a federally regulated credit card company. The lower court had determined that the National Bank Act and federal regulations of the Office of the Comptroller of the Currency preempted the application of New York law to Simon Gift cards. In 2006, the U.S. Treasury Department's Office of Thrift Supervision ("OTS") had issued a legal opinion stating that that federal law preempts state gift laws, such as restrictions on expiration dates and fees, when the cards are issued by federal savings associations. The appellate court, however, found that because Simon sold and marketed the gift cards, New York law applied. This was a surprisingly and unsettling finding for many gift card issuers who had assumed that the federally regulated component of the co-branded credit card absolved them of the need to comply with the patchwork of state gift card laws. In addition, the appellate court found that here was no private right of action for violations of the New York gift certificate statute, General Business Law Sec. 396-i, which authorizes only the Attorney General to file an action for a violation of its provisions. The court, however, found that General Business Law Sec. 349(h), which governs unfair and deceptive practices, did expressly provide for a private right of action.

Because of the appellate court's findings, the case will now proceed to determine whether notices for the card's dormancy fee were adequate. In addition to actual damages of up to $50, the New York statute permits recovery of alternative treble damages (up to $1,000), in the court's discretion, and reasonable attorneys' fees.

If the claims prove successful, there could be serious implications under New York law for gift cards, including cards that are co-branded with federally regulated credit cards that contain fees and other terms and conditions.

Recent case challenges gift card under New Jersey law, resulting in public speculation about issuing company's financial well-being.

Vona v. Foot Locker, Inc., Superior Court of New Jersey, Middlesex County (Case No. MID-L-45-00008)

A purchaser of a gift card in New Jersey recently filed a class action complaint alleging that Foot Locker, Inc. ("Foot Locker") violated New Jersey law by selling gift cards that imposed a dormancy fee after twelve months of non-use. The plaintiff contends that Foot Locker violated the gift card

provisions contained in the New Jersey Consumer Fraud Act and New Jersey's Truth-in-Consumer Contract, Warranty and Notice Act. The plaintiff seeks actual and statutory damages and injunctive relief on behalf of a putative consumer class who purchased gift cards from Foot Locker in New Jersey on or after April 4, 2006.

New Jersey's gift card law, N.J.S.A. § 56:8-110, prohibits the charging of dormancy fees during the twenty-four months following the date the card is sold or following the most recent use of the card. In addition, New Jersey's gift card law requires that any expiration date or dormancy fee be disclosed in at least ten point font on the gift card, sales receipt for the gift card, or the gift card's packaging. The state law also requires the provision of a telephone number that consumers may call for information about a gift card's expiration date and dormancy fees. (Of note, a pending New Jersey bill would prohibit expiration dates and dormancy fees altogether.)

The plaintiff contends that Foot Locker violated New Jersey's gift card law by selling a $25 gift card, which imposed a $1.50 dormancy fee after twelve consecutive months of non-use. Further, the plaintiff alleges that Foot Locker's disclosure of the dormancy fee was inadequate under state law because it was printed on the card in less than ten point font. The plaintiff also contends that Foot Locker failed to provide the requisite telephone number information on the gift cards.

The publicity caused by the case and the speculation about the financial ramifications of the gift card program prompted Foot Locker's COO to issue a letter to the public in November 2008 regarding the company's financial well-being.

Economic downturn and influx of bankruptcies cause uncertainty about the future of gift card programs.

The tumbling economy has forced many major retailers in bankruptcy, such as Circuit City and Linen-N-Things. As creditors line up to stake their claims, what becomes of unspent gift cards issued by bankrupt retailers? Most companies do not maintain reserve accounts for gift card fulfillment, so when the retailers close their doors, consumers holding unredeemed gift cards from those retailers are typically out of luck and must wait in line with other creditors for the slim chance of a payout.

For example, in 2008, Sharper Image filed for bankruptcy protection, leaving gift card holders with approximately $20 million in unredeemed gift cards. At first, Sharper Image did not plan to honor the unused gift cards, but later petitioned the bankruptcy court to allow it to honor gift cards if consumers spent double the value of the gift card on a single purchase. Similarly, Bombay Co., a furniture retailer, also filed for bankruptcy in 2008 and sought approval from the bankruptcy court to pay its gift card holders twenty-five cents on the dollar.

In September 2008, the Consumers Union, which publishes *Consumer Reports* and other organizations such as the Consumers Federation of America, National Consumer Law Center and

U.S. PIRG (Public Interest Research Group), asked the Federal Trade Commission (FTC) to protect gift card holders from losing money when retailers file for bankruptcy. The coalition has taken the position that gift card issuers must be required to hold the money earned from gift card sales in trust accounts for honoring gift cards if the issuing retailers remain in business after filing for bankruptcy. The FTC is reportedly considering the proposal. If adopted, the policy could significantly affect the maintenance of and long-term accounting for gift card programs.

A handful of other states have laws that dictate what happens to gift cards the event of bankruptcy or liquidation. However, the laws may prove ineffective in protecting gift card holders when the issuers file for bankruptcy because the laws may conflict with federal bankruptcy law.

Conclusion: Navigating Gift Card Potholes Requires Wise Counsel

Compliance with the ever-changing patchwork of state and federal laws affecting the issuance and fulfillment of gift cards can be daunting. Nonetheless, gift card programs continue to be highly lucrative, popular, and effective marketing tools, even in these uncertain economic times. In order to avoid implicated legal pitfalls and garner the benefits of a successful gift card program, legal review at the inception and during the tenure of gift card programs is imperative. This is particularly the case as economic instabilities continue, more states pass and amend gift card laws, and federal regulators increasingly investigate gift card-related unfair trade practices.

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