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# Developments in the Law Concerning Stored Value and Other Prepaid Payment Products

*By Sarah Jane Hughes, Stephen T. Middlebrook, and Broox W. Peterson\**

## INTRODUCTION

Stored value cards, known in the industry as “prepaid” products, are the most recent big success in the payments industry. Consumers, merchants, bankers as well as the media, legislatures and regulators have taken notice. The most familiar prepaid card products are transportation and telephone cards, which this article does not discuss, and gift cards. Among the more recent additions to prepaid card products is the payroll card. Use of both gift cards and payroll cards has been expanding rapidly. Gift cards essentially are “gift certificates” with magnetic strips. They may be issued for use at one merchant, such as those issued by national retailers of books, coffee, and groceries, or for use at a wider variety of merchants, such as cards carrying the Visa and MasterCard logos. Payroll cards can substitute

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Stephen T. Middlebrook is Senior Counsel, U.S. Department of the Treasury; he is the co-chair of the Working Group on Electronic Payments, ABA Cyberspace Law Committee (2006–present). He is responsible for Part I of this article, titled “Recent Developments in the Federal Regulation of Stored Value.” Research for Part I is current through June 8, 2006. The views expressed in Part I of this article are the author’s own and do not necessarily reflect the views of the U.S. Department of the Treasury.

Sarah Jane Hughes is the University Scholar and Fellow in Commercial Law at the Indiana University School of Law-Bloomington. She is the author of Part II of the article, titled “Consumer-Related Developments Pertaining to Payroll Cards, Gift Cards, and Other Stored-Value Products.” She serves as co-chair of the Working Group on Electronic Payments, ABA Cyberspace Law Committee (2006–present) and chair (2000–2006). She was a Senior Attorney in the Division of Credit Practices (now Financial Practices), Bureau of Consumer Protection at the U.S. Federal Trade Commission prior to joining the Indiana University School of Law faculty and has been involved with payments products issues since 1976. Her research covers the period from January 1, 2005, to May 24, 2006.

Broox W. Peterson was Senior Vice President and Assistant General Counsel with Visa from 1983 to 2005. He currently is in private practice providing payments and intellectual property consulting and transaction support services. He is responsible for Part III of this article, titled “Federal Preemption of State Consumer Protection Regulation of Gift Cards.” Research for Part III is current through August 26, 2006.

The authors invite readers to direct questions on each section of this article to the individual author who is named above as primarily responsible for its content. Copies of many of the documents cited in the article may be found on the Electronic Payments Working Group’s webpage at <http://www.abanet.org/dch/committee.cfm?com=CL320040>.

for traditional checks as a method of paying one-time or recurring wages in many industries.

Gift cards, by all accounts, are booming:

Gift cards continue to be a huge and growing business. One estimate is that there were \$79.04 billion of gift card transactions in 2004 and that that figure will grow to \$94.84 billion in transactions in 2005. Of course, as with many retail items, the holiday season is the peak for gift card sales. The National Retail Federation's ("NRF") 2005 Gift Card Survey found that 75.5 percent of consumers plan to purchase at least one gift card this holiday season and predicts \$18.48 billion in holiday gift card sales, a 6.6 percent increase over 2004.<sup>1</sup>

An Accenture survey of 526 companies following the 2005 Christmas holiday season revealed that 82% of the respondents gave or received gift cards and 66% both gave and received them.<sup>2</sup>

Gift cards are highly appealing to issuers. Value that cardholders never use can amount to 10% of the value on the card, although that amount has reportedly been dropping recently.<sup>3</sup>

Usage of other prepaid payment products has also increased dramatically, including payroll cards<sup>4</sup> and state electronic benefit cards.<sup>5</sup> Prepaid cards were also part of the Hurricane Katrina Relief efforts by the American Red Cross and, briefly, by the federal government through the Federal Emergency Management Agency and U.S. Department of the Treasury.<sup>6</sup>

Given the increased interest in these products, members of the Working Group on Electronic Payments of the Cyberspace Law Committee have prepared brief discussions of the most salient developments since the last Cyberspace Law Committee Survey that covered electronic financial services in 2002.<sup>7</sup> This article is organized in three parts—(i) federal regulatory developments, (ii) gift card and

1. Montgomery County Division of Consumer Affairs, *Gift Cards 2005: Many Good Retail Cards, Any Good Bank Cards?* (December 2005), at 1 (citations omitted), available at [http://www.montgomerycountymd.gov/content/ocp/consumer/gift\\_cards\\_report\\_2005.pdf#search=%22Gift%20Cards%202005%3A%20Many%20good%20retail%20cards%22](http://www.montgomerycountymd.gov/content/ocp/consumer/gift_cards_report_2005.pdf#search=%22Gift%20Cards%202005%3A%20Many%20good%20retail%20cards%22).

2. Accenture, *News Release*, January 30, 2006, available at [http://www.accenture.com/xd/xd.asp?it=enweb&xd=\\_dyn/dynamicpressrelease\\_950.xml](http://www.accenture.com/xd/xd.asp?it=enweb&xd=_dyn/dynamicpressrelease_950.xml).

3. See <http://www.trintech.com/ElectronicGiftCardsFAQs.html#q14>.

4. Payroll cards "function very much like branded gift cards but with ATM access, [and] are funded by one or more accounts into which an employer deposits employees' wages. ATM & Debit News reports that there are 3.5 million such cards in the U.S., and it expects that number to double in the next three years." Mark Furetti, *Prepaid Cards: How Do They Function? How Are They Regulated?*, Philadelphia Federal Reserve Bank Payments Center (June 2004), at 10, available at [http://www.phil.frb.org/pcc/papers/Prepaid\\_Cards.pdf#search=%22Prepaid%20cards%3A%20How%20do%20they%20function%22](http://www.phil.frb.org/pcc/papers/Prepaid_Cards.pdf#search=%22Prepaid%20cards%3A%20How%20do%20they%20function%22).

5. *Debit Is Putting Jobless Checks Out of Work*, Vol. 7 No. 39, ATM AND DEBIT NEWS, October 26, 2006, at 1.

6. For information on the FEMA stored value card program in Texas, see "FEMA Expedited Assistance Continues Flowing" (September 9, 2005), available at <http://www.fema.gov/news/newsrelease.fema?id=18758> (announcement of pilot program to issue cards to Katrina evacuees in three Texas shelters worth \$12.3 million); Carissa D. Mire, *Agency to End Debit Card Plans*, HOUSTON CHRONICLE, Sept. 11, 2005, at 2, available at <http://www.chron.com/disp/story.mpl/special/05/katrina/3347947.html>.

7. Judith Rinearson, *Regulation of Electronic Stored Value Payment Products Issued By Non-Banks Under State "Money Transmitter" Licensing Laws*, 58 BUS. LAW. 317 (2002).

payroll card laws or regulations in various states,<sup>8</sup> and (iii) federal preemption of state gift card laws. Each of the substantive parts reviews a different legal aspect of these complex but growing payment products.

## I. RECENT DEVELOPMENTS IN THE FEDERAL REGULATION OF STORED VALUE

Federal regulation of stored value cards (“SVCs”) started off strong in 1996 when the Office of the Comptroller of the Currency<sup>9</sup> (“OCC”), the Board of Governors of the Federal Reserve (“the Board”) and the Federal Deposit Insurance Corporation (“FDIC”) all issued guidance regarding the new payment mechanisms. When that guidance was not well received,<sup>10</sup> the regulators held back for eight years, and have only recently begun reissuing guidance on stored value products. Several pronouncements made over the past year provide an interesting glimpse into the thought processes of federal regulators struggling to deal with real problems in the rapidly evolving world of financial services when they are still tied to antiquated statutes and their own regulatory history. We see the FDIC, after two initial missteps, setting out a simple rule for determining the insurability of all stored value products. The Board, having been reprimanded for taking a broad approach in 1996,<sup>11</sup> has chosen a more focused path, writing rules applicable to one particular stored value product, payroll cards.

### A. FDIC AMENDS FEDERAL DEPOSIT INSURANCE RULES TO COVER STORED VALUE PRODUCTS

#### 1. FDIC Insurance—Is It Always A Good Thing?

It might seem like an obvious benefit to the issuers of stored value to be able to say their product is “FDIC Insured,” but that appellation may not be consistent with the business model under which some issuers operate. For a card holder to receive the benefit of FDIC insurance, the FDIC has proposed that the issuer must waive any right to ownership in the underlying funds and must maintain records that correlate card holders and accounts.<sup>12</sup> Although the latter requirement is basically a technical issue, the former raises a business decision with several im-

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8. Lawyers researching the law of gift and payroll cards should think expansively. Substantive gift card provisions are found in freestanding gift card amendments to older gift certificate laws, in consumer protection laws, and in abandoned property laws. See *infra* notes 63–64 and text accompanying, which cite examples of all three types of laws. Payroll card provisions are found in state wage and hour laws and state regulations. See *infra* notes 83–95 and text accompanying for examples.

9. In 1996, the OCC issued several opinions in which it held that nationally chartered banks may issue stored value products. See E-Z Pass System, Interpretive Letter No. 731 (July 1, 1996), available at <http://www.occ.treas.gov/interp/july/int731.htm>; Huntington Bank, Interpretive Letter No. 737 (August 19, 1996), available at [www.occ.treas.gov/interp/sept/int737.htm](http://www.occ.treas.gov/interp/sept/int737.htm); *Mondex*, Conditional Approval No. 220 (December 2, 1996), available at [www.occ.treas.gov/interp/dec/conda220.pdf](http://www.occ.treas.gov/interp/dec/conda220.pdf).

10. See *infra* notes 23, 36–37 and accompanying text.

11. See *infra* notes 36–37 and accompanying text.

12. Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. 45571, 45581 (Aug. 8, 2005) (proposed 12 C.F.R. § 330.5(c)(3)).

plications. Some stored value products are structured so that funds remaining on lost or expired cards (sometimes referred to as “breakage”) revert to the card issuer through dormancy fees before the funds escheat to the state.<sup>13</sup> This practice would seem at odds with the FDIC proposed requirement that, if the value of the SVC is to be insured to the card holder, the card issuer must relinquish any claim to the underlying funds. In other words, card issuers must choose between FDIC insurance and collecting the breakage.

When the money backing the stored value, often called the “funds pool,” is held in an insured financial institution, it is protected by the FDIC to the same extent as any other deposit.<sup>14</sup> The big question regarding insurance of an account that holds a funds pool is who is the beneficiary? As is explained below, the FDIC is willing to view the funds pool as a single account belonging to the card issuer or as multiple accounts belonging to the card holders. If the stored value program is structured so that the FDIC views the funds as one account, then the standard rule applies and the card issuer is protected up to \$100,000.<sup>15</sup> On the other hand, if the program is structured so that the funds pool could be viewed as multiple accounts, then the FDIC has proposed that each card holder be protected up to \$100,000.<sup>16</sup>

An employer issuing payroll cards or a retailer issuing gift cards that structures the program so that it is the owner of the funds pool account and beneficiary of the insurance is exposing itself to significant liability if the financial institution holding the funds fails. Imagine that the bank holding the \$10 million funds pool backing a retailer’s gift card program becomes insolvent. If the retailer asserts ownership of the funds pool and consequently is the beneficiary of the FDIC insurance, it is covered for only \$100,000—a tiny fraction of its loss. Card holders will expect the retailer to honor the millions of dollars worth of cards issued regardless of the status of the bank and the sufficiency of the deposit insurance. This liability could potentially force the retailer into bankruptcy itself. If, on the other hand, the retailer has waived ownership rights to the funds pool and the FDIC insurance benefits the retailer’s customers, then each card holder is covered up to \$100,000. In this scenario, each card holder is made whole by the FDIC and the retailer faces no liability. Passing insurance coverage through to card holders ultimately protects the card issuer from liability should the financial institution holding the funds become insolvent.

## 2. FDIC’s Early Attempts to Regulate Stored Value

Early FDIC regulation of stored value sprang from the definition of the term “deposit” in the Federal Deposit Insurance Act.<sup>17</sup> Interpreting that term in 1996,

13. See Anita Ramasastry, *State Escheat Statutes and Possible Treatment of Stored Value, Electronic Currency, and Other New Payment Mechanisms*, 57 *BUS. LAW.* 475, 477–78 (2001).

14. See generally 12 U.S.C.A. §§ 1811–35 (West 2001 & Supp. 2006) (authorizing the FDIC to insure certain deposits at certain financial institutions).

15. 12 C.F.R. § 330.6 (2006).

16. See *infra* notes 25–29 and accompanying text.

17. 12 U.S.C. § 1813(l) (2000).

the FDIC issued General Counsel's Opinion No. 8, which divided stored value products into four different categories depending in part on who collected the funds backing the SVCs, who paid out the funds, and whether the funds were held in individual accounts or a "pooled" reserve account.<sup>18</sup> This highly structural approach was difficult to understand and ultimately provided little practical guidance to institutions interested in issuing SVCs.<sup>19</sup> The FDIC let the opinion stand for eight years until publication of what is now referred to as the First Proposed Rule in 2004<sup>20</sup> ("First Proposed Rule"). This proposed regulation purported to respond to new SVC products in the market, such as payroll cards and gift cards by amending the definition of "deposit" in the regulations. The FDIC jettisoned the four old categories of SVC products and their emphasis on the distinction between individual and pooled accounts in favor of a completely new set of categories that focused on the source of funds and the issuer of the SVC.<sup>21</sup> Inexplicably, the FDIC also limited the scope of the rule to the purchase of merchandise at the retail point-of-sale, completely ignoring the possibility that the card might be used to obtain cash from a merchant or at an ATM.<sup>22</sup> Because commentators raised this and other significant issues with the proposed changes, the FDIC decided not to promulgate its 2004 proposal in final form, and instead published a Second Proposed Rule in 2005<sup>23</sup> ("Second Proposed Rule").

### 3. FDIC's Second Proposed Rule

This version of the rule takes a more nuanced approach to the regulation of stored value cards in general and their relationship to deposit insurance. The FDIC acknowledged that SVCs are not really as unique a financial instrument as previously thought and in fact share many characteristics with checks, traveler's checks and money orders in that they all provide access to money stored at a bank.<sup>24</sup> The FDIC noted that when a money transmitter deposits the proceeds from the sale of money orders into a bank, those funds are indisputably "deposits" for purposes of the Federal Deposit Insurance Act.<sup>25</sup> Similarly, the funds backing a SVC that are placed in a bank would clearly be "deposits" entitled to FDIC insurance.<sup>26</sup>

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18. General Counsel's Opinion No. 8; Stored Value Cards, 61 Fed. Reg. 40490, 40493-95 (August 2, 1996).

19. See Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. 45571, 45576 (August 8, 2005) ("The confusion regarding the applicability of GC8 is an important reason for replacing GC8 with a regulation.").

20. Definition of "Deposit": Stored Value Cards, 69 Fed. Reg. 20558 (April 16, 2004) (proposed 12 C.F.R. § 303.16).

21. *Id.* at 20565-66 (proposed 12 C.F.R. §§ 303.16(b), (c) and (d)).

22. *Id.* at 20566 (proposed 12 C.F.R. § 303.16(f), defining "stored value card" as a device used to transfer funds "to a merchant at the merchant's point of sale terminal").

23. Deposit Insurance Coverage; Stored Value Cards and Other Nontraditional Access Mechanisms, 70 Fed. Reg. 45571 (August 8, 2005).

24. *Id.* at 45574.

25. *Id.* at 45575 (citing FDIC Advisory Opinion No. 91-21 (March 21, 1991)).

26. *Id.* at 45575 n.4.

The real question is who is the proper beneficiary of that insurance—the card holder or the card issuer? If the benefit of the insurance is to inure to the card holder, the bank must know the identity of that person. Depending on the way the stored value system is implemented, the bank may or may not always have that information.

Perhaps the major difference between stored value cards and traditional access mechanisms is that the holder of a stored value card, unlike the holder of an ATM card, need not deal directly with a bank. Rather, the holder of a stored value card may deal with either a bank or a third party.<sup>27</sup>

If the customer acquired the SVC through the financial institution, then both it and the FDIC *likely* would know the card holder's identity in the event the FDIC needed to pay insurance benefits. If the card holder has dealt with a third-party issuer, however, the bank may or may not know the identity of the card holder, depending on whether the issuer shares that information.

These arrangements create the possibility that the insured depository institution will possess no records as to the identities of the holders of the access mechanisms. An absence of such records appears especially likely in the case of low-denomination, transferable gift cards. In the event of the failure of the insured depository institution, the anonymity of the holders of the access mechanisms would create an obvious problem for the FDIC in attempting to pay deposit insurance.<sup>28</sup>

The insurance question then becomes a question of knowing the identity of the card holders.

In its Second Proposed Rule, the FDIC articulates a practical and relatively simple solution to this problem. If the account records indicate that the funds backing the SVCs do not belong to the party that deposited the funds (which might be an employer, processor, marketer or other institution), and either the bank or the depositing party maintains records reflecting the identity of the card holder, then the funds are insured to the card holder. If the account records indicate that the funds backing the SVCs belong to the depositor, or if neither the bank nor the card issuer maintains sufficient records to identify the card holder, then the funds are insured to the issuer.<sup>29</sup>

In an apparent acknowledgement that the technology of payment systems moves more quickly than the regulation of those payment systems, the FDIC took the bold move of making its Second Proposed Rule applicable to more than just SVCs. The proposal applies to a new category of products which the FDIC calls "Nontraditional Access Mechanisms."<sup>30</sup> The Second Proposed Rule does not define the term, but rather provides a list of examples of covered products and mechanisms:

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27. *Id.* at 45574–75.

28. *Id.* at 45577.

29. *Id.* at 45580 (proposed 12 C.F.R. § 330.5(c)).

30. *Id.* at 45580 (proposed 12 C.F.R. § 330.5(c)(1)).

... cards, codes, computers or other electronic means, to the extent that such mechanisms provide access to funds received and held by an insured depository institution for payment to others.<sup>31</sup>

This broad definition makes it clear that the new rule covers stored value of all types (stored value cards, prepaid debit cards, payroll cards, EBT cards, radio transponders, radio frequency identification devices, etc.) as well as on-line “person-to-person” payment accounts, e-wallets, cell phone “e-purses” and whatever other new electronic payment mechanisms come onto the market.

## **B. FEDERAL RESERVE BOARD AMENDS REGULATION E TO COVER PAYROLL CARDS**

In many situations, when a person uses a debit card to pay for something, “the basic rights, liabilities, and responsibilities” of the card holder as well as the entity that issued the card are set out in Regulation E.<sup>32</sup> The primary objective of Regulation E is the protection of individual consumers engaging in electronic fund transfers.<sup>33</sup> The regulation addresses a range of issues from required notices and receipts to dispute resolution processes and liability for unauthorized transactions.<sup>34</sup> Like all regulations, its text is filled with jargon and terms of art. For example, Regulation E applies when a “consumer” uses an “access device” to initiate an “electronic fund transfer” from a “consumer asset account.”<sup>35</sup> Despite the precision of the regulation’s wording, it is often difficult to know whether a stored value product falls within the ambit of Regulation E. This is especially true of stored value products, such as payroll cards, that have only recently entered the market. Although the Board has attempted to clarify the application of Regulation E to stored value products, its efforts have had limited success.

### **1. The Board’s Early Attempts to Regulate Stored Value**

The Board’s very first attempt to regulate stored value came with a proposed amendment to Regulation E issued in 1996.<sup>36</sup> Congress, however, delayed implementation of the proposed amendment until the Board conducted a study determining whether the Electronic Funds Transfer Act could be applied to stored value products without adversely affecting the cost, operation and development of such products.<sup>37</sup> The Board completed that study,<sup>38</sup> but has never moved forward with its broad original amendment regarding stored value.

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31. *Id.*

32. 12 C.F.R. § 205.1(b) (2006) (describing the objectives of Regulation E).

33. *Id.*

34. *See* 12 C.F.R. §§ 205.7, 205.9, 205.11, 205.6 (2006).

35. 12 C.F.R. § 205.2 (2006) (defining all terms in Regulation E).

36. Electronic Fund Transfers, 61 Fed. Reg. 19696 (May 2, 1996).

37. The Economic Growth and Regulatory Paperwork Reduction Act of 1996, Pub. L. No. 104-208, § 2601, 1996 U.S.C.A.N. (110 Stat.) 3009, 3009-469.

38. Board of Governors of the Federal Reserve System, Report to the Congress on the Application of the Electronic Fund Transfer Act to Electronic Stored-Value Products (March 1997), available at [http://www.federalreserve.gov/boarddocs/rptcongress/efra\\_rpt.pdf](http://www.federalreserve.gov/boarddocs/rptcongress/efra_rpt.pdf).



The Board remained “hands-off” on stored value products until September 2004, when, perhaps spurred by a nudge from the OCC,<sup>39</sup> it published a new proposed amendment to Regulation E.<sup>40</sup> Whereas the FDIC expanded its rule to cover all “nontraditional access mechanisms,” the Board took an opposite approach—abandoning its broad 1996 rule in favor of a narrow regulation focusing on a subset of stored value products referred to as “payroll cards.” The Board accepted comments on its 2004 proposal and subsequently issued an Interim Final Rule in late 2005<sup>41</sup> (“Interim Final Rule”).<sup>42</sup>

## 2. The Board Extends Regulation E to Cover Payroll Cards

In the Interim Final Rule, the Board amended the definition of “consumer asset account” for purposes of Regulation E to include:

a “payroll card account” directly or indirectly established by an employer on behalf of a consumer to which electronic fund transfers of the consumer’s wages, salary, or other employee compensation are made on a recurring basis, whether the account is operated or managed by the employer, a third-party payroll processor, a depository institution or any other person.<sup>43</sup>

The Board concluded that “there is no substantive difference between a subaccount and an individual account for purposes of determining whether Regulation E coverage is appropriate.”<sup>44</sup> In its commentary to the rule, the Board made clear that payroll accounts are covered whether they are held in individual accounts or a pooled account and without regard to which entity—employer, third-party processor, depository institution, or other entity—provides the accounting or subaccounting.<sup>45</sup> In Regulation E parlance, an entity with compliance obligations has always been referred to as a “financial institution,” so in order for the Board to bring employers and processors under the purview of the Interim Final Rule, it had to modify the definition of “financial institution” to include them.<sup>46</sup>

39. In May 2004, the OCC issued an opinion letter stating that it was permissible for national banks to issue payroll cards. Office of the Comptroller of the Currency, Payroll Card Systems, Advisory Letter AL 2004-6 (May 6, 2004), available at <http://www.occ.treas.gov/ftp/advisory/2004-6.doc>. In that letter, the OCC noted that the question of whether Regulation E applies to payroll cards was “unsettled” and cautioned banks engaged in payroll card activities to address appropriately issues of consumer disclosures, consumer fees, error resolution processes, limits on consumer liability and other issues covered by Regulation E. *Id.* The letter also warned banks about the absence of deposit insurance for payroll card products at that time. *Id.*

40. Electronic Fund Transfers, 69 Fed. Reg. 55996 (September 17, 2004) (proposed 12 C.F.R. §§ 205.2, 205.3, 205.7).

41. Electronic Fund Transfers, 71 Fed. Reg. 1473 (January 10, 2006) (proposed 12 C.F.R. §§ 205.2, 205.18). The Board solicited comments on the Interim Final Rule, particularly on alternative means to provide periodic statement information until March 2006.

42. As this article was in progress, the Federal Reserve Board issued a final rule dealing with various payroll card issues. 71 Fed. Reg. 51437 (August 30, 2006).

43. 71 Fed. Reg. at 1481 (proposed 12 C.F.R. § 205.2(b)(2)) (effective July 1, 2007).

44. *Id.* at 1475.

45. *Id.*

46. 71 Fed. Reg. at 1481 (proposed 12 C.F.R. § 205.18) (“A person is a financial institution for purposes of the act . . . if it . . . directly or indirectly issues an access device to a consumer for use in initiating an EFT from a payroll card account.”).

### 3. Consumer Protection Provisions for Payroll Cards

In its 2004 publication, the Board proposed that all of the consumer protection provisions of Regulation E (including initial disclosures, periodic statements, and error resolution procedures) should apply to payroll card accounts.<sup>47</sup> Industry commentators, however, disagreed with aspects of the proposal, especially the requirement to provide traditional periodic paper statements to payroll card holders, and suggested that payroll cards should be subject to rules similar to those imposed on Electronic Benefit Transfers, which allow for substitutes for paper statements.<sup>48</sup> The Board studied the use of paper statements by card holders and determined that it was “appropriate to provide flexibility”<sup>49</sup> with regard to paper statements. Consequently, the Board modified the rule to allow financial institutions<sup>50</sup> to provide an alternative to paper statements. The alternative requires that (1) account balance information be made available by telephone, (2) 60 days of account history be made available electronically, and (3) 60 days of account history be made available in writing upon request by the card holder.<sup>51</sup> In addition, a financial institution opting to provide alternative statement information must also provide a modified initial disclosure with information about account fees.<sup>52</sup>

The Board also proposed new rules for determining when the consumer’s 60-day time period for reporting errors and the time period for a financial institution’s liability begins to run.<sup>53</sup> For example, if the employee obtains account information electronically, the 60-day period commences on the date the account is accessed by the employee electronically.<sup>54</sup> However, if the employee requests a written transaction history, the 60-day period will commence when the employer, processor, or institution sends the written history to the employee.<sup>55</sup>

### 4. Potential Conflicts with State Law

Finally, the Board’s Interim Final Rule may create tension with certain state laws concerning payroll cards. Regulation E contains a general provision against “com-

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47. Electronic Fund Transfers, 69 Fed. Reg. 55996, 55999 (Sept. 17, 2004). For a detailed analysis of the application of consumer protection requirements to stored value under the Interim Final Rule, see *infra* Part III of this article.

48. 71 Fed. Reg. at 1475–76. See 12 C.F.R. § 205.15(c) (2005) (alternatives to periodic statements for EBT accounts).

49. 71 Fed. Reg. at 1476.

50. As noted above, the Interim Final Rule includes employers within the definition of the term “financial institution” to the extent “they are involved in the transfer of funds to the payroll card account or in the issuance of the card.” *Id.* at 1477. Regulation E also covers as a “financial institution” a person that directly or indirectly holds a payroll card account or directly or indirectly issues a payroll account card. 71 Fed. Reg. at 1481 (proposed 12 C.F.R. § 205.18(a)).

51. 71 Fed. Reg. at 1481–82 (proposed 12 C.F.R. § 205.18(b)).

52. 71 Fed. Reg. at 1482 (proposed 12 C.F.R. § 205.18(c)).

53. 71 Fed. Reg. at 1478 (proposed 12 C.F.R. § 205.18(c)(3) and (4)).

54. 71 Fed. Reg. at 1478 (proposed 12 C.F.R. § 205.18(c)(4)). The Board does not intend for the 60-day period to begin to run from when a cardholder merely visits the Internet website where she can access information on her payroll card account, but rather to begin to run when the cardholder has entered a user identification code or password or complies with a security procedure to be used to verify the consumer’s identity. *Id.*

55. 71 Fed. Reg. at 1482 (proposed 12 C.F.R. § 205.18(b)(iii)).

pulsory use” that prevents financial institutions and employers from requiring a person to set up an account as a condition of employment.<sup>56</sup> In its commentary, the Board acknowledges that this provision precludes an employer from requiring an employee to receive a payroll card and suggests that employees always be given some other option, such as direct deposit to a financial institution of their choice.<sup>57</sup> The Board’s approach appears to conflict with certain state laws that allow employers to mandate use of a payroll card.<sup>58</sup>

### CONCLUSION: FEDERAL REGULATION OF STORED VALUE IS BECOMING MORE CONSISTENT

Both the FDIC and the Board are to be commended for their shared conclusion that the structure of stored value accounts and the decision as to who maintains card holder data—both unknown to the consumer—should not affect the application of consumer protection rules to stored value products. The two regulators, however, have taken divergent views on how broadly to apply their new analysis, with the FDIC staking claim to all nontraditional access mechanisms and the Board limiting its Interim Rule to the narrow category of payroll cards. It is unfortunate that federal regulators cannot agree on more.

## II. CONSUMER-RELATED DEVELOPMENTS PERTAINING TO PAYROLL CARDS, GIFT CARDS, AND OTHER PREPAID CARD PRODUCTS

### INTRODUCTION

Since the 2002 Cyberspace Survey covering electronic payment products, federal and state consumer protection developments relating to stored value cards have taken various forms. The two most prominent of these developments are Regulation E’s new coverage of payroll cards,<sup>59</sup> covered in Part I of this article, and state legislation governing both gift cards and payroll cards, which is covered in this section. Other important developments include (a) actions brought by state attorneys general involving the Simon Mall gift cards;<sup>60</sup> and (b) actions brought by the Federal Trade Commission (“the FTC”) because consumers received loadable stored-value cards instead of the credit cards they had been prom-

56. 12 C.F.R. § 205.10(e)(2) (2006) (“No financial institution or other person may require a consumer to establish an account for receipt of electronic funds transfers with a particular institution as a condition of employment or receipt of a government benefit.”).

57. 71 Fed. Reg. at 1479.

58. See, e.g., MICH. COMP. LAWS ANN. § 408.476 (West Supp. 2006) (allowing Michigan employers to mandate use of a payroll card by employees). See *infra* notes 87–90 and accompanying text for a discussion of state law approaches to compulsory use.

59. Electronic Fund Transfers, 71 Fed. Reg. 1473 (Jan. 10, 2006) (to be codified at 12 C.F.R. pt. 205). Part I of this article, *supra*, discusses the interim final rule.

60. For discussion of the *Simon* litigation and the federal preemption doctrine, see Part III of this article.

ised by telemarketers.<sup>61</sup> The bait-and-switch practices prosecuted by the FTC may damage consumers' acceptance of stored-value cards. Negative experiences with stored valued cards could prompt more legislative and regulatory action on stored value products.

Numerous states enacted new consumer protection legislation covering gift cards or payroll cards or amended existing laws with effective dates in 2005 or 2006. The pattern emerging from new state laws is one of disparity in treatment on important consumer protection issues and on issues of essentially technical detail. This section briefly summarizes issues on which state laws now differ the most.

### A. RECENT STATE GIFT CARD LAWS: EXPIRATION, DORMANCY AND OTHER FEE DISCLOSURE AND LIMITATIONS ISSUES DOMINATE

Apart from applying their state escheat laws to stored value cards,<sup>62</sup> states that also have adopted laws or regulations pertaining to gift cards<sup>63</sup> include Arizona, California, Connecticut, Georgia, Hawaii, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Montana, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, and Washington.<sup>64</sup> Lawyers researching state gift

61. E.g., Federal Trade Comm'n v. Bay Area Business Council, Inc, 423 F.3d 627, 634–36 (7th Cir. 2005) (affirming summary judgment on telemarketers violations of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (2000), and the FTC's Telemarketing Sales Rule, 16 C.F.R. pt. 310 (2005)); respondents falsely guaranteed consumers a security-deposit-free MasterCard with an initial "pay as you go" limit of \$2,000, but delivered a no credit line "ChexCard" and required receipt of a separate \$15 activation fee prior to use); Federal Trade Comm'n v. Platinum Universal, LLC, No. 03-61987 CIV (S.D. Fla.) (filed Nov. 2003), available at <http://www.ftc.gov/os/caselist/0323143/0323143.htm>; Federal Trade Commission, *FTC, Partners Put Stop to Canadian Cross-Border Frauds* (Sept. 27, 2005), available at [www.ftc.gov/opa/2005/09/pacificlibertycenturion.htm](http://www.ftc.gov/opa/2005/09/pacificlibertycenturion.htm) (enforcement action developed in conjunction with U.K., Canadian, and various state and local law enforcement agencies); Federal Trade Comm'n v. 3R Bancorp, Civ. No. 04 C 7177 (N.D. Ill.) (filed Nov. 2004), available at <http://www.ftc.gov/os/caselist/0423030/0423030.htm>.

62. State escheat laws are beyond the scope of this article.

63. Some states that regulate prepaid products do not call those products "gift cards." See, e.g., HAW. REV. STAT. § 481B-13(e) (Supp. 2005).

64. ARIZ. REV. STAT. ANN. §§ 44-7401, 44-7402 (Supp. 2005); CAL. CIV. CODE §§ 1749.45, 1749.5 (West Supp. 2006) (requiring expiration date to be printed on card and allowing dormancy charges if certain conditions are met, respectively); CONN. GEN. STAT. ANN. § 3-56a and § 42-460 (West 2000 & Supp. 2006); DEL. CODE ANN. tit. 12, §§ 1198(8), 1199(a), 1199(g), 1212 (2001 & Supp. 2005); GA. CODE ANN. § 10-1-393 (Supp. 2006); HAW. REV. STAT. § 481B-13 (Supp. 2005); 815 ILL. COMP. STAT. ANN. 505/2QQ(b) (West Supp. 2006) (gift certificates); IOWA CODE ANN. § 556.9(2) (West Supp. 2005); 2006 Kan. Sess. Laws ch. 116 (H.B. 2658) (April 14, 2006); 2006 Ky. Acts ch. 28 (SB 49) (March 24, 2006); LA. REV. STAT. ANN. § 51:1423 (Supp. 2006); 2005 Md. Laws ch. 456 (S.B. 8) (May 26, 2005) (to be codified at MD. CODE ANN. COM. LAW § 14-1319); MASS. GEN. LAWS ch. 266, § 75C (Supp. 2006); MONT. CODE ANN. § 30-14-102(5)(a) (2005) (as amended by 2005 Mont. Laws ch. 291); 2006 Neb. Laws L.B. 173 (Mar. 6, 2006) (amending NEB. REV. STAT. § 69-1305.02(3) to provide provisions on dormancy fees and disclosure of dormancy fees in escheat provisions); NEV. REV. STAT. § 598.0921 (2005); N. J. STAT. ANN. § 56:8-110 (West Supp. 2006); N. C. GEN. STAT. ANN. § 116B-54 (West 2005) (expiration date disclosure relevant to escheat); N.D. CENT. CODE § 51-29-01 (Supp. 2005) (adding gift card to categories covered by gift certificate law); 2006 Ohio Laws 80 (Sub.

card laws should be aware that core consumer protection provisions in some states are found in “abandoned property” statutes or in amendments to earlier “gift certificate” statutes, rather than in freestanding “gift card” consumer protection statutes.<sup>65</sup>

State gift card laws vary considerably in terms of required disclosures and substantive requirements, such as limitations on dormancy fees, expiration dates, and the form and font sizes for disclosures. Most states require disclosure at the time of sale of service charges,<sup>66</sup> dormancy fees,<sup>67</sup> or expiration dates.<sup>68</sup> Others prohibit dormancy fees,<sup>69</sup> or other service charges.<sup>70</sup> Some prohibit card expiration while the card still holds value.<sup>71</sup> And others impose fines on sales of gift cards that limit use to less than one,<sup>72</sup> two,<sup>73</sup> five<sup>74</sup> or seven years.<sup>75</sup> Some states prohibit expiration<sup>76</sup> or service or other fees unless the issuer discloses the expiration date or fee at the time of sale.<sup>77</sup> Others prohibit expiration unless the expiration feature is disclosed at the time of sale and provide that, absent disclosure, the card value must be available in perpetuity.<sup>78</sup> Some of these expiration rules may conflict with states’ explicit escheat laws.<sup>79</sup>

States’ gift cards laws differ substantially in their technical requirements. For example, some states prohibit collection of fees or card expiration in the absence of disclosures in 10-point type on the front or back of the gift card.<sup>80</sup> Other states

S.B. 33) (Mar. 14, 2006) (to be codified at OHIO REV. CODE ANN. § 1349.61); OKLA. STAT. ANN. tit. 15, §§ 795–98 (West Supp. 2007); R.I. GEN. LAWS § 6-13-12 (Supp. 2006); 2005 S. C. LAWS ACT 2 (H.B. 4688) (Nov. 4, 2004) (to be codified at S.C. CODE ANN. § 39-1-55); 2006 TENN. LAWS CH. 622 (H.B. 2574) (to be codified at TENN. CODE ANN. § 47-18-127); TEX. BUS. & COM. CODE ANN. § 35.42 (Vernon Supp. 2006); VT. STAT. ANN. tit. 8, §§ 2701–11 (Supp. 2006); VA. CODE ANN. §§ 59.1-530–532 (2006); WASH. REV. CODE ANN. § 19.240.005–900 (West Supp. 2007).

65. E.g., CONN. GEN. STAT. ANN. § 3-56a and § 42-460 (West 2000 & Supp. 2006).

66. E.g., 815 ILL. COMP. STAT. ANN. 505/2QQ(b) (West Supp. 2006) (gift certificates).

67. E.g., VT. STAT. ANN. tit. 8, § 2703 (Supp. 2006).

68. E.g., 815 ILL. COMP. STAT. ANN. 505/2QQ(b) (West Supp. 2006) (gift certificates).

69. E.g., HAW. REV. STAT. § 481B-13(a) (Supp. 2005).

70. E.g., LA. REV. STAT. ANN. § 51:1423B(2) (Supp. 2006) (allows one-time handling fee not to exceed one dollar per gift certificate).

71. E.g., R.I. GEN. LAWS § 6-13-12 (Supp. 2006) (imposing the no-expiration term and a \$200 fine for violating it).

72. E.g., 2005 S. C. LAWS ACT 2 (H.B. 4688) (Nov. 4, 2004) (to be codified at S.C. CODE ANN. § 39-1-55) (prohibiting expiration in less than one year but not explicitly stating a fine for violation).

73. 2006 Ohio Laws 80 (Sub. S.B. 33) (Mar. 14, 2006) (to be codified at OHIO REV. CODE ANN. § 1349.61) (effective June 15, 2006) (prohibiting sales of gift cards containing expiration date of less than two years, but not stating a fine).

74. E.g., LA. REV. STAT. ANN. § 51:1423B(1) (Supp. 2006).

75. E.g., MASS. GEN. LAWS ch. 266 § 75C (Supp. 2006) (fines of \$300 for violations).

76. E.g., LA. REV. STAT. ANN. § 51:1423C (Supp. 2006) (cards sold without disclosed expiration dates valid until redeemed or replaced).

77. *Id.*

78. E.g., HAW. REV. STAT. § 481B-13(b) (Supp. 2005).

79. For more information on state escheat laws, see Anita Ramasastry, *State Escheat Statutes and Possible Treatment of Stored Value, Electronic Currency, and Other New Payment Mechanisms*, 57 BUS. LAW. 475 (2001).

80. E.g., NEV. REV. STAT. § 598.0921 (2005); OKLA. STAT. ANN. tit. 15, § 797 (West Supp. 2007) (requiring 1-point type, capital letters, and placement on the front of the gift card or gift certificate).

require disclosures in 6-point type.<sup>81</sup> Still other states regulate the location of disclosures requiring, for example, placement on the front of the gift card or on receipts given at the time of sale.<sup>82</sup> Differences in regulatory requirements of these types burden multi-state, non-depository issuers of gift cards and suggest the need for greater uniformity.

## B. STATE PAYROLL CARD LEGISLATION

Seven states have enacted laws or promulgated regulations governing the payment of wages by payroll cards, rather than by direct deposit or check,<sup>83</sup> or have otherwise regulated the use of payroll cards.<sup>84</sup> Among these, Michigan's law, which became effective on January 3, 2005, allows employers to pay wages with payroll cards without the employee's consent;<sup>85</sup> and Minnesota's, which offers employees the option to take wages in the form of payroll cards and became effective June 3, 2005,<sup>86</sup> are among the newest.

Conditions on payroll cards differ substantially from state to state. Three features of state payroll card laws warrant special mention: (1) employee choice versus compulsory use, (2) full availability of wages, and (3) fee-free use of the compensation paid or pre-disclosed fee requirements for payroll paid by debit cards.

### 1. Employee's Choice to Take Wages in Stored Value Form

The issue of mandatory versus voluntary acceptance of debit cards by employees is one of the hot issues in state payroll card legislation. In states such as Minnesota,<sup>87</sup> employees have the *option* of being paid by electronic fund transfers to payroll card accounts.<sup>88</sup> Minnesota also requires that the employee voluntarily consent in writing to the payroll card method of payment.<sup>89</sup> The Regulation E

81. E.g., WASH. REV. CODE ANN. § 19.240.040 (West Supp. 2007).

82. E.g., ARIZ. REV. STAT. ANN. § 44-7402.A -C. (Supp. 2005) (timing of disclosure before sale); 2005 Md. Laws ch. 456 (S.B. 8) (May 26, 2005) (to be codified at MD. CODE ANN. COM. LAW § 14-1319 & 14-1320(b)-(c) (respectively, location and type size of disclosures, and visibility requirement for disclosures and type size or requirement of separate written disclosure statement given to purchases before sale or issuance).

83. 65-400-013 DEL. CODE REGS. §§ 1-3 (2005); ME. REV. STAT. ANN. tit. 26, § 663, subsec. 5 (Supp. 2006); 2005 Md. Laws ch. 573 (H.B. 751) (May 26, 2005) (to be codified at MD CODE ANN. LAB. & EML. § 3-502); MICH. COMP. LAWS ANN. § 408.476 § 6 (West Supp. 2006); MINN. STAT. § 177.23, subd. 4 and § 177.255 (2006); NEV. ADMIN. CODE § 608.135 (2005); N.D. CENT. CODE § 34-14-02 (Supp. 2005); VA. CODE ANN. § 40.1-29 (Supp. 2006). Oklahoma includes payroll cards among the categories of financial institution products covered by rules limiting out of state depositories for public funds. OKLA. STAT. ANN. tit. 62, § 71(C) (West Supp. 2007).

84. Delaware and Nevada have regulations on payroll cards. 65-400-013 DEL. CODE REGS. §§ 1-3 (2005); NEV. ADMIN. CODE § 608.135 (2005). This article does not discuss state escheat laws that apply to payroll cards.

85. MICH. COMP. LAWS ANN. § 408.476 (West Supp. 2006).

86. MINN. STAT. §§ 177.23, 177.255 (2006) (definitions and substantive conditions on payroll card accounts).

87. *Id.* at § 177.255.

88. *Id.* at § 177.255, subd. 5.

89. *Id.* at § 177.255, subd. 6.

amendments may have resolved the “choice” issue for payroll cards by the Board’s refusal to budge on the Electronic Fund Transfer Act’s prohibition on compulsory use.<sup>90</sup>

## 2. Full Availability of Wages Paid with Payroll Cards

“Full availability” is the second issue. States such as Minnesota require that the “employee who chooses to be paid wages by electronic fund transfer to a payroll card account must be permitted to withdraw by a free transaction from the employee’s payroll card account, an amount up to and including the total amount of the employee’s entire net pay, as stated on the employee’s earnings statement. . . .”<sup>91</sup> This presents a potential problem for the employee who earned, for example, \$224.32 in a given pay period. ATM machines do not dispense amounts such as the \$4.32 in this example—or indeed any amount that does not coincide with the face values of generally \$20 bills and, in some locations, \$10 bills. Thus, in states such as Minnesota, the employee needs to use the card in a retail transaction or may be able to get cash back at a retailer, such as grocery stores, in a pin-based transaction. Alternatively, the employee may have to pay a fee to a depository institution to obtain the “total amount” of the entire net pay. Despite the regulation in Minnesota of the total obligation being available, its law does not address how the employee gets that last increment of her pay, \$4.32 in the above example, without incurring some inconvenience or possibly a fee. To date, it is unclear whether “full availability” is a serious problem or merely a theoretical concern.

## 3. “Fee-Free” Use of Payroll Cards

The third issue is “free use” of the wages. Essentially, some states require that employees be able to get wages without associated fees. Delaware’s new “payroll debit card” provisions require the fee-free use of compensation paid through payroll cards.<sup>92</sup> Maine’s law allows employees to be paid through direct deposit systems, ATM cards or other means of electronic transfer as long as the employee[s] either can make “an initial withdrawal of their entire net pay without additional cost to the employee or the employee can choose another means of payment that involves no additional cost to the employee.”<sup>93</sup> Maryland, on the other hand, does not prohibit fees but rather requires that the employer disclose fees ap-

90. See *supra* notes 57–58 and accompanying text in Part I for more information on Regulation E’s prohibition on compulsory use.

91. MINN. STAT. § 177.255, subd. 4 (2006).

92. 65-400-013 DEL. CODE REGS. § 2.0 (2005). For employees who do not maintain their own bank accounts, Delaware also provides that the employer, upon a written request from the employee, may deposit funds into an individual bank account assigned to the employee, but requires that “[c]osts associated with accounts established for the unbanked employee who voluntarily participates in the payroll debit card individual account program must be under reasonable circumstances.” *Id.* at § 3.0.

93. ME. REV. STAT. ANN. tit. 26, § 663, subs. 5 (Supp. 2006); see also MICH. COMP. LAWS ANN. § 408.476 § 6 (West Supp. 2006). Additionally, employers may not require that employees pay “any fees or costs.” *Id.*

plicable to payroll debit cards or card accounts in writing in at least 12-point font.”<sup>94</sup> Minnesota prohibits employers from charging fees for “initiation, participation, loading, or other fees to receive wages in an electronic fund transfer to a payroll card account.”<sup>95</sup>

### CONCLUSION: STATE VERSUS FEDERAL PROTECTIONS FOR GIFT AND PAYROLL CARDS

A patchwork of state laws and regulations now cover gift cards or payroll cards. State gift-card laws differ significantly in terms of rules on dormancy and other fees, expiration and disclosure of expiration dates, and requirements for disclosures. The growing number and extremely technical nature of state requirements for gift card sales demonstrates the challenge of non-uniformity for multi-jurisdictional issuers that are not federally chartered depository institutions.<sup>96</sup> Nationwide card issuers who are not able to take cover under the preemption offered by federal banking regulations<sup>97</sup> are likely to press for more homogenized rules on fees and disclosures.

In addition, conflicts between state gift card and escheat rules may require additional state action. For example, state laws that provide either for no expiration for gift cards in the absence of disclosure of expiration dates, or that allow for long periods prior to expiration may trump shorter escheat provisions. Such conflicts may require clarification through state regulator opinions or legislation.

Regulation E’s new coverage of payroll cards when the employer plans to use them on a recurring basis, and regardless of whether the employer, a third-party payroll processor, or a depository institution issues the payroll card, provides many consumers key transactional protections of Regulation E and the Electronic Fund Transfer Act. State payroll card provisions outside the scope of the interim final Regulation E are no more uniform than are state gift card laws and pressures for more consistent laws are likely to come from nationwide employers and others. The Board may determine that Regulation E’s prohibition on compulsory use, described in Part I, preempts state laws that allow compulsory use rather than employee choice.

### III. FEDERAL PREEMPTION OF STATE CONSUMER PROTECTION REGULATION OF GIFT CARDS

State legislatures and regulators have watched closely the success of gift cards. The previous section in this article describes various legislative and regulatory

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94. 2005 Md. Laws ch. 573 (H.B. 751) (May 26, 2005) (to be codified at MD CODE ANN. LAB. & EMPL. § 3-502).

95. MINN. STAT. § 177.255, subd. 12 (2006).

96. See Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (amending 12 C.F.R. pts. 34 (real estate lending) and 7 (deposit-taking, non-real estate lending and other activities)); Office of Thrift Supervision, John E. Bowman, Chief Counsel, Preemption of State Gift Restrictions, P-2006-3 (June 9, 2006), available at <http://www.ots.treas.gov/docs/5/56218.pdf>.

97. For more discussion on preemption by federal bank regulators, see Part III of this article.



responses by the states to protect their citizens who purchase gift cards. Attempts by states to enforce these laws in connection with gift card programs involving national banks have resulted in litigation raising interesting, and sometimes novel, issues of federal preemption under the National Bank Act and regulations of the federal Office of the Comptroller of the Currency ("OCC"). The Office of Thrift Supervision ("OTS") has also recently added its voice to the debate on behalf of federal savings associations.

### A. THE NATIONAL BANK ACT ESTABLISHES FEDERAL PREEMPTION

The national banking system was established in 1863.<sup>98</sup> At the same time, the OCC was established as the regulator of national banks, with the sole authority to examine, supervise, and regulate national banks, unless otherwise provided by federal law.<sup>99</sup> Congress intended to make the National Bank Act the only law applicable to national banks, preempting state law under the Supremacy Clause of the U.S. Constitution.<sup>100</sup> Since that enactment, the principle that states have no authority over national bank activities except as expressly permitted by federal law has been confirmed in numerous Supreme Court decisions.<sup>101</sup>

### B. STATES ATTEMPT TO REGULATE NATIONAL BANKS

The states keep trying to regulate national banks and federal savings associations. For instance, since 2000, courts have struck down state regulation of national banks and federal savings associations prohibiting ATM access fees and check cashing fees, regulating ATM placement and advertising, and requiring certain disclosures on credit card billing statements.<sup>102</sup>

### C. 2004 OCC PREEMPTION RULES

In apparent response to this spate of litigation, in August 2003, the OCC proposed amendments to OCC regulations to clarify the scope of and standards for

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98. The National Currency Act, providing for the organization of National Banks, was adopted February 25, 1863 (ch. 58, 12 Stat. 665). A year later Congress amended the Act and renamed it the National Bank Act. (ch. 106, 13 Stat. 99 (June 3, 1864)).

99. National Bank Act, ch. 106, § 8, 13 Stat. at 101-02.

100. U.S. CONST. art. VI, cl. 2. See 12 U.S.C. § 484(a) (2000) ("No national bank shall be subject to any visitatorial powers except as authorized by Federal Law . . .").

101. See, e.g., *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 10 (2003).

102. E.g., *Bank of America, N.A. v. City and County of San Francisco*, No. C-99-4817 VRW, 2000 WL 33376673, \*4 (N.D. Cal. June 30, 2000), *aff'd*, 309 F.3d 551 (9th Cir. 2002), *cert. denied*, 538 U.S. 1069 (2003) (ATM access fees); *Metrobank, N.A. v. Foster*, 193 F. Supp. 2d 1156, 1161 (S.D. Iowa 2002) (ATM access fees); *Wells Fargo Bank of Tex., N.A. v. James*, 321 F.3d 488, 491-92 (5th Cir. 2003) (check cashing charge); *Bank of America, N.A. v. Sorrell*, 248 F. Supp. 2d 1196, 1199 (N.D. Ga. 2002) (check cashing charge); *BankOne Utah, N.A. v. Guttaw*, 190 F.3d 844, 849-50 (8th Cir. 1999), *cert. denied*, 529 U.S. 1087 (2000) (ATM location, operation and advertising); *American Bankers Ass'n v. Lockyer*, 239 F. Supp. 2d 1000, 1020-21 (E.D. Cal. 2002) (requirement to disclose amount of time required to pay balance with minimum monthly payments).

federal preemption of state regulation impacting national banks.<sup>103</sup> After a comment period, the OCC adopted amendments to its rules consistent with its proposal, and based on principles firmly established in Supreme Court decisions.<sup>104</sup> These amendments specify that state laws are preempted to the extent they “obstruct, impair, or condition a national bank’s ability to fully exercise its powers.”<sup>105</sup> The amended rules also specify those state laws that generally are not preempted, which the OCC deemed to affect only incidentally the exercise of national bank powers.<sup>106</sup>

#### D. THE STATES FIGHT BACK

If the OCC had hoped that the clarifications in its rules would be welcome they were not. Preemption of state law is never popular among states, and when the purpose of the state law involved is consumer protection, the fuzzy line between politics and policy becomes particularly indistinct. Before the OCC published its preemption rules, a number of Democratic members of the House of Representatives Financial Services Committee requested a delay in their publication to give Congress more time to consider their implications.<sup>107</sup> Following adoption of the OCC preemption rules, Congress asked the Government Accountability Office (“GAO”) to investigate the process followed in promulgating the rules, and the GAO report concluded that the OCC complied with the appropriate statutory framework.<sup>108</sup> On July 26, 2005, legislation was introduced in the 109th Congress to narrow the OCC preemption rule and require national banks to comply with state consumer protection legislation applicable to state banks.<sup>109</sup> The OCC responded to criticism of its preemption rules by pointing out that it has a history of exercising its strong supervisory oversight to herd the

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103. Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 46119 (Aug. 5, 2003). The OCC has authority under 12 U.S.C. § 93a (2000) “to prescribe rules and regulations to carry out the responsibilities of the office,” which includes the responsibility to protect the ability of national banks to operate as intended by Congress to the full extent of their powers. 12 U.S.C. § 24(Seventh) (2000) permits national banks to exercise “all such incidental powers as shall be necessary to carry on the business of banking.” This is a flexible and evolving power. See *Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 258 n.2 (1995).

104. Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (amending 12 C.F.R. pts. 34 (real estate lending) and 7 (deposit-taking, non-real estate lending and other activities). Amendments to Part 34, which address real estate lending powers of national banks, are not discussed in this article.

105. E.g., 12 C.F.R. § 7.4009(b) (2006).

106. For example, the OCC exempted contracts, torts, criminal law, rights to collect debts, acquisition and transfer of property, taxation, zoning, and “any other law the effect of which the OCC determines to be incidental to the exercise of national bank powers or otherwise consistent with the powers set forth in paragraph (a) of this section.” 12 C.F.R. § 7.4009(c)(2)(viii) (2006).

107. See [http://www.house.gov/banking\\_democrats/pr021204.html](http://www.house.gov/banking_democrats/pr021204.html).

108. Government Accountability Office, OCC Preemption Rulemaking (2005), available at <http://www.gao.gov/htext/d068.html>.

109. H.R. 3426, 109th Cong. (2005), S.1502, 109th Cong. (2005). As of October 2006, no action has been taken on these bills.

national banks away from abusive practices without having to adopt formal rules.<sup>110</sup>

On another front, the U.S. Supreme Court on June 19, 2006, granted a petition for certiorari by the State of Michigan Office of Insurance and Financial Services<sup>111</sup> seeking review of a Sixth Circuit opinion upholding the preemption of registration by Michigan of a state-chartered mortgage lending subsidiary of Wachovia National Bank.<sup>112</sup> The petition asserted that the OCC exceeded its authority in adopting the OCC Rule, which provides that preemption of state laws under the National Bank Act applies to non-bank operating subsidiaries of national banks as well.<sup>113</sup> Questions that the U.S. Supreme Court will address are whether the OCC's determination is entitled to deference under applicable precedent<sup>114</sup> and whether the OCC Rule violates the Tenth Amendment to the U.S. Constitution.<sup>115</sup> Relevant to the subject of preemption of state gift card regulations, it is clear that there will be some vetting by the Court of the ability of the OCC to adopt rules that preempt state consumer protection regulation.

### E. STATE ATTORNEYS GENERAL FIND A NICHE

On November 15, 2004, the attorneys general of the States of Massachusetts, Connecticut, and New Hampshire sued Simon Property Group<sup>116</sup> in their respec-

110. See OCC News Release No. 2005-117 (December 1, 2005), available at <http://www.occ.treas.gov/toolkit/newsrelease.aspx?Doc=151QIBS3.xml> (quoting speech by Comptroller John Dugan in which he "took issue with the notion that national bank preemption has created a 'regulatory gap' in consumer protection, citing the strong provisions in federal law and the OCC's extensive enforcement powers and supervisory oversight, along with differences in state and federal regulation that result from federalism and the dual banking system.").

111. *Watters v. Wachovia Bank, N.A.*, 126 S. Ct. 2900 (2006).

112. *Wachovia Bank N.A. v. Watters*, 431 F.3d 556 (6th Cir. 2005).

113. Brief for the Petitioner for Writ of Certiorari, *Watters v. Wachovia Bank, N.A.* 126 S. Ct. 2900 (Mem.) (No. 05-1342), available at 2006 WL 2570336. The OCC rule can be found at 12 C.F.R. § 7.4006 (2006).

114. The questions on which certiorari was granted are available at <http://www.supremecourt.us/gov/qp/05-01342qp.pdf> ("... The Comptroller of the Currency, by Rule 12 C.F.R. 7.4006, made 12 U.S.C. § 484(a) equally applicable to State-chartered nonbank 'operating subsidiaries' of national banks. Is the interpretation of the Comptroller of the Currency that 12 C.F.R. 7.4006 preempts Michigan's laws regulating mortgage lending as applied to State chartered nonbank operating subsidiaries, entitled to judicial deference under *Chevron USA, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984)?").

115. *Id.* ("The Tenth Amendment to the United States Constitution is violated to the extent a statute permits the conversion of State corporations into federal ones in contravention of the laws of the place of their creation, *Hopkins v. Federal Savings & Loan Ass'n v. Cleary*. Does 12 C.F.R. 7.4006, by equating a State-chartered nonbank operating subsidiary with a national bank for purposes of federal preemption of State regulation, violate the Tenth Amendment to the United States Constitution?").

116. Simon Property Group is the largest operator of shopping malls in the United States, with ownership interests in 285 properties in 39 states plus Puerto Rico. It offered a Visa-branded Simon Gift Card, usable at all Simon mall properties and at any merchant worldwide that accepts Visa cards. It is an "open loop" gift card, issued in conjunction with a national bank, with processing services provided by a non-bank third party. See Complaint, *State of Connecticut v. Simon Property Group, Inc.*, Superior Court, Hartford Judicial District, Civ. Act. No. CV-04-4005355-S (Nov. 15, 2004) ¶¶ 6-13 (copy on file with author and *The Business Lawyer*). Additional information about the Simon gift cards is available at [www.simon.com](http://www.simon.com).

tive state courts for violation of state gift certificate and consumer protection laws.<sup>117</sup> The complaints listed the various fees charged in connection with Simon Gift Cards sold in their states,<sup>118</sup> and alleged either the fees were prohibited by state law, were unfair, or were deceptively imposed because of inadequate disclosure.<sup>119</sup> In February 2005, the State of New York also sued Simon for violation of state law.<sup>120</sup> The New York litigation was settled in March 2005.<sup>121</sup> Simon agreed to comply with New York law prohibiting the imposition of service fees prior to the thirteenth consecutive month of non-use of the card and to disclose the lost card and expired card re-issuance fees on the gift card itself.<sup>122</sup> Simon asserted the defense of federal preemption in these suits because a national bank was the issuer of the gift card, but did not have much success with this defense.

Matters did not start out well for Simon in Massachusetts, when the then-acting Chief Counsel of the OCC wrote a letter dated January 5, 2005, to the Massachusetts Attorney General “clarifying” the position of the OCC on certain issues in the Massachusetts litigation.<sup>123</sup> The state actions against Simon were carefully pleaded in that they did not name Bank of America, which was Simon’s national bank partner for this card program, and alleged that the fees in question were fees determined and collected by Simon, not the Bank of America.<sup>124</sup> On that basis, apparently, the OCC, while acknowledging that the facts in the litigation were complicated and in some respects disputed, stated its “belief” that “the state restrictions on **Simon’s** fees would not be preempted” (bold in original) by the

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117. Complaint, Commonwealth of Massachusetts v. Simon Property Group, Inc., Suffolk Superior Court, Civ. Act. No. 04-4993 (Dec. 15, 2004); Complaint, State of Connecticut v. Simon Property Group, Inc., Superior Court, Hartford Judicial District, Civ. Act No. CV-04-4005355-S (Nov. 15, 2004); Complaint, Kelly Ayotte, Attorney General, State of New Hampshire v. Simon Property Group, Inc., Civ. Act. No. 04-CV-426-JD, Superior Court Merrimack SS (Nov. 15, 2004) (Copies on file with author and *The Business Lawyer*).

118. Examples of fees mentioned include: \$5.95 shipping and handling for merchandise if purchased on-line, \$1.50 if purchased in-mall; \$2.50 per month service fee after 6 months; \$.50 per call to determine balance on card after first call; \$5.00 reissue fee for lost or stolen card; if card expires with a balance, a \$7.50 fee to apply the balance against to a new card. Massachusetts Complaint, *supra* note 117, ¶¶ 15–18; Connecticut Complaint, *supra* note 117, ¶¶ 14–17; New Hampshire Complaint, *supra* note 117, ¶¶ 13–14.

119. Massachusetts Complaint, *supra* note 117, ¶¶ 33–41; Connecticut Complaint, *supra* note 117, ¶¶ 27–34; New Hampshire Complaint, *supra* note 117, ¶¶ 18–43.

120. Verified Petition, New York v. Simon Property Group, Inc., No. 400425/05 (N.Y. Sup. Ct. 2005), available at <http://www.oag.state.ny.us/press/2005/feb/SimonPetition.02.01.05.pdf>.

121. The New York statute, N.Y. GEN. BUS. LAW § 396-i (McKinney Supp. 2006), had been in effect only since October 2004, so the accrued penalties of \$1,000 per violation under the statute may have persuaded Simon to cut its losses in New York and focus on the litigation in the other states, where its potential penalties were much larger. Simon paid \$100,000 in penalties and \$25,000 in costs as part of the settlement in New York. The New York Attorney General was the last to sue but the first to settle. Consent Order and Judgment, New York v. Simon Property Group, Inc., No. 400425/05 (N.Y. Sup. Ct. Mar. 17, 2005), available at <http://www.oag.state.ny.us/press/2005/mar/Consent%20Order%20and%20Judgment.pdf>.

122. *Id.*

123. Copy of letter on file with author and *The Business Lawyer*.

124. Massachusetts Complaint, *supra* note 117, *passim*; Connecticut Complaint, *supra* note 117, *passim*; New Hampshire Complaint, *supra* note 117, *passim*.

National Bank Act and OCC Regulations.<sup>125</sup> There have been no other public developments in the Massachusetts action.

On January 5, 2006, the U.S. District Court for the District of Connecticut granted a motion by Simon for reconsideration of the court's ruling dismissing Simon's lawsuit challenging enforcement of the Connecticut Gift Card Law. Simon filed this action after the state action filed by the Connecticut Attorney General.<sup>126</sup> However, the District Court proceeded to find that the NBA did not preempt the Connecticut Gift Card Law, and that the law did not violate the Commerce Clause.<sup>127</sup> With respect to the preemption finding, the court found that the fees in question were fees determined and collected by Simon, not Bank of America, and thus the National Bank Act was inapplicable.<sup>128</sup>

In New Hampshire, there were two actions as well. Simon filed first in federal district court seeking a ruling that the relevant portions of the New Hampshire consumer protection law were preempted and that the application of that law also violated the Commerce Clause of the U.S. Constitution.<sup>129</sup> The State filed in a local superior court.<sup>130</sup> Ultimately ruling on a newly revamped Simon Visa Gift Card program under which MetaBank and U.S. Bank, both national banks, were participants, the federal district court found on summary judgment that the application of New Hampshire's gift card regulations was preempted by federal regulation. The court found this preemption applied not only to these federally chartered financial institutions, but also as to third parties, such as Simon, which assist in the marketing and sale of those institutions' products.<sup>131</sup> The court did not rule on the Commerce Clause question, because the preemption finding made it moot.<sup>132</sup>

## F. THE OTS TAKES A FIRM STAND

The Chief Counsel for the OTS, in an opinion issued June 9, 2006, declared that OTS regulation preempts the state laws in question in the *Simon* litigation, as well as other state laws directed at gift cards, when applied to federal savings association gift card programs.<sup>133</sup> The gift cards in question were issued and sold solely by the federal savings associations, and not by third parties, so that the

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125. Letter from Acting Chief Counsel, Office of the Comptroller of the Currency, to Massachusetts Attorney General, January 5, 2005, at 2.

126. SPGGC, Inc. v. Blumenthal, 408 F. Supp. 2d 87 (D. Conn. 2006).

127. *Id.* at 102.

128. *Id.* at 94 (Simon as "[a]n entity that is neither a national bank, nor a wholly-owned subsidiary of a national bank, may not claim preemption based on the NBA, and the fact that a non-bank entity claims to have any agency or business relationship with a national bank does not give that entity the right to claim preemption based on the NBA.").

129. Civil Action No. 04-CV-420-SM (Nov. 12, 2004).

130. New Hampshire Complaint, *supra* note 117.

131. SPGGC, LLC v. Ayotte, 443 F. Supp. 2d 197 (D.N.H. 2006).

132. *Id.*

133. Opinion of Chief Counsel, Office of Thrift Supervision, P-2006-03 (June 9, 2006), available at <http://164.109.59.122/docs/5/56218.pdf>. The five general categories of state laws discussed in the opinion are (i) licensing requirements, (ii) disclosure requirements, (iii) fee restrictions, (iv) expiration date restrictions, and (v) cash redemption requirements. *Id.*

OTS did not have to address whether OTS regulation preempts state law as to non-financial institution participants in gift card programs.<sup>134</sup> The OTS' theory of preemption was also slightly different than that adopted by the OCC, although the difference is not significant.<sup>135</sup> It is worth noting that the OTS Opinion makes it clear that the OTS has and uses its authority to require federal savings associations to comply with *consumer protection rules* in connection with gift card programs, including full and fair disclosure to consumers of terms,<sup>136</sup> and the discussion suggests that the savings association program under review passed muster.

### CONCLUSION: WHAT DO THESE DEVELOPMENTS MEAN FOR FEDERAL PREEMPTION?

There should be no question that, like the OTS, the OCC has the authority to fend off the states seeking to regulate the gift card activities of national banks.<sup>137</sup> Four states implicitly acknowledged this by asserting their claims only against Simon, and for that courtesy the OCC, under political attack in Congress and the states, may have reciprocated by letting the state attorneys general seek to enforce their state consumer protection laws against a highly visible defendant. Simon was the one that set the fees that were being attacked, with Bank of America playing a minimal role in the program, and perhaps the OCC was not sure where the preemption lines should be drawn with regard to a third party participating in a national bank-issued retailer gift card program.

Unfortunately, the OCC has created uncertainty about the scope of federal preemption. Are national-bank-issued, co-branded credit card programs a model for retailer gift card programs whose terms should be preempted from state regulation? There is usually some form of revenue sharing between the co-brand partner and bank in credit-card, co-branded programs, but the nature and extent of the fees that are charged in connection with gift card programs are quite different.<sup>138</sup> The OCC may want more time to consider and weigh in on the nature

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134. *Id.* But see *State Farm Bank, F.S.B. v. Burke*, 05-CV-808, 2006 WL 1728919 (D. Conn. June 21, 2006), in which a federal district court in Connecticut upheld a 2004 OTS interpretation that exclusive agents of federally chartered savings associations were entitled to the same federal preemption as were their principals under applicable law and OTS regulation.

135. The OTS takes the position that its regulation has preempted the field permitting no state regulation at all impacting federal savings associations. Opinion of Chief Counsel, Office of Thrift Supervision, P-2006-03 (June 9, 2006), *supra* note 133, at n.34. The OCC rejected that theory in favor of a conflict analysis, noting that the OTS has adopted comprehensive and wide-ranging regulations, which the OCC does not favor (68 Fed. Reg. 46119, 46123 (August 5, 2003)), and as legal matter, the same substantive results are obtained under either approach (69 Fed. Reg. 1904, 1910-11 (Jan. 13, 2004)).

136. Opinion of Chief Counsel, Office of Thrift supervision, P-2006-03 (June 9, 2006), *supra* note 133, at 9-11.

137. See Office of the Comptroller of the Currency, *Mondex*, Conditional Approval 220 (December 2, 1996), available at <http://www.occ.treas.gov/interp/nov/conda220.htm> (concluding that the stored value business is a permissible activity of national banks).

138. Credit-card programs are well-known for finance charges, late fees, over-limit fees and cash advance fees, while gift cards have issuance fees, dormancy fees and the myriad of other fees vetted in the litigation over the Simon gift cards.

and reasonableness of these fees and how they are shared before it expresses an opinion on these national bank-issued retailer gift card programs.<sup>139</sup>

## V. CONCLUSION

Since the last Cyberspace Law Survey that covered electronic payments products in 2002, we have seen major developments in federal and state laws and regulations affecting those who issue and those who use stored value payment products. Among the more substantial of these are actions by the FDIC extending federal deposit insurance to payroll and gift cards in certain circumstances and by the Board extending Regulation E to payroll cards; preemption of state gift card laws by the OCC and OTS for those federally chartered depository institutions under their respective jurisdictions; and enactment of new state laws governing aspects of gift cards and payroll cards. Actions by the FDIC, Board, OCC, and OTS afford issuers of stored value products more certainty in terms of predicting which laws govern their businesses. State laws and regulations that govern non-depository issuers of stored value products seem to cry out for more uniform solutions to the myriad of technical issues still facing those who issue and those who use stored value cards.

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139. On August 14, 2006, the OCC issued guidance to national banks concerning gift card program consumer disclosures. OCC Bulletin, 2006-34 (August 14, 2006), available at <http://www.occ.treas.gov/ftp/bulletin/2006-34.txt>. Critics complained that the guidance does not require national banks to comply with state laws prohibiting dormancy fees and practices such as expiry dates, just to disclose those practices clearly. See, e.g., *Cracking Down on Gift Cards*, available at [http://blog.washingtonpost.com/thecheckout/2006/08/cracking\\_down\\_on\\_gift\\_cards.html](http://blog.washingtonpost.com/thecheckout/2006/08/cracking_down_on_gift_cards.html).