

Court Boosts Federal Preemption In Stored Value Gift Card Case

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A federal district court in New Hampshire has ruled that federal preemption bars state regulation of stored value gift cards against the issuing banks' agent, a non-bank. Here, the author discusses the ruling and explains its significance.

The law is quite clear that state statutory or regulatory provisions that purport to limit fees that may be charged to the holder of a stored value gift card, or that otherwise impose restrictions on the contractual relationship between the cardholder and an issuing national bank or federal savings association, are preempted by federal law.¹ As the District Court for the District of Connecticut recently observed:

“Because the [Office of the Comptroller of the Currency] explicitly authorizes national banks to charge [their] customers fees, any state law that impairs a national bank from exercising its federally authorized power to charge fees could arguably be preempted by the [National Bank Act]. The rationale underlying that conclusion is that Congress has clearly expressed its intent for national banks to be regulated by federal authority. Complying with both laws could cause an irreconcilable conflict, because the OCC has ruled that, when it explicitly authorizes a national bank to exercise a power, a state may not infringe that authorization.”²

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Recently, in *SPGGC, LLC v. Ayotte*,³ a federal district judge in New Hampshire considered whether a state could enforce provisions of its Consumer Protection Act against the agent of issuing banks, rather than against either of the banks. The court's decision finding preemption is a boon to the stored value gift card industry, helping to reinforce the rule that one regulatory scheme—the federal one—should govern, rather than a hodgepodge of state or local regulations.

THE GIFTCARDS

The case was brought by SPGGC, LLC (Simon), an affiliate of Simon Property Group, L.P., which owns and operates shopping malls across the United States, including three in the State of New Hampshire. Simon is not a bank, a bank subsidiary, or a bank affiliate. In August 2001, Simon began selling the Simon Visa Giftcard (the Giftcard). The Giftcard has been available in Simon malls in New Hampshire since 2003, and also has been sold over the Internet.

The Giftcards were prepaid electronic stored value cards. They looked like a credit card or bank debit card, consisting of an embossed plastic card with a magnetic information strip on the back, which operated on the Visa debit infrastructure. The purchaser of a Giftcard specified the amount, or value, that he or she wanted to place on the Giftcard and a balance in that denomination (less an initial "handling fee") was established on the card. Unlike a traditional gift certificate, however, the Giftcard could be replaced if lost or stolen, and its owner was not responsible for unauthorized uses of the card.

Simon claimed that to comply with Visa fraud prevention and card maintenance requirements, all Giftcards, including those sold in New Hampshire, had to bear an expiration date. Also, unlike a traditional gift certificate, several fees and charges were associated with the Giftcard, which Simon said was levied to recover administrative costs associated with maintaining the Giftcard program.

The Simon Giftcards sold over the Internet were issued by Metabank, a federal savings association organized under the Home Owners' Loan Act (HOLA)⁴ while those sold at Simon malls were issued by U.S. Bank, a

national bank organized under the National Bank Act (NBA).⁵ Metabank and U.S. Bank were the banking entities that actually owned and issued the prepaid Simon Giftcards.

Under the terms of the agreement between U.S. Bank and each purchaser/holder of the Giftcard, the following fees and charges applied: an initial \$2.00 “handling fee,” a \$2.50 monthly “service fee” (which was waived during the first 12 months), a \$5.00 “lost or stolen card” fee, and a \$15.00 “balance transfer or cash-out fee” upon the Giftcard’s expiration. The Giftcards expired a minimum of 20 months after purchase. The fee schedule applicable to cards issued by MetaBank was similar: a \$5.95 handling fee, a \$2.50 monthly administrative fee beginning 12 months after issuance of the card, a \$5.00 fee to replace a lost or stolen card; and a \$15.00 fee to replace an expired card.

When Simon sold a Giftcard to a consumer, it collected payment from the consumer and a corresponding amount (less the initial handling fee) was loaded onto the card. Simon also provided the consumer with a copy of the Giftcard agreement between the consumer and the issuing bank. U.S. Bank claimed it accounted for the value loaded onto each Giftcard as a liability running from the bank to the consumer, and it booked the fees collected as part of the Giftcard sale as income. At the end of each quarter, U.S. Bank paid a commission to Simon, based on the total amount of Giftcard value sold, which commission U.S. Bank booked as an expense. As the consumer redeemed the Giftcard, U.S. Bank remitted monies to merchants through the Visa settlement network. If any additional fee-generating events occurred (*e.g.*, replacement of a lost or stolen card), those fees were imposed by (and retained by) U.S. Bank. MetaBank’s accounting practices were similar.

New Hampshire notified Simon that its sale of Giftcards violated various provisions of New Hampshire’s Consumer Protection Act (CPA)⁶ and indicated it intended to file an enforcement action under that statute to halt the sale of the Giftcards. In response, Simon filed suit in New Hampshire federal court, seeking declaratory and injunctive relief. U.S. Bank and MetaBank were granted leave to intervene as plaintiffs.

THE STATE'S ARGUMENT

The state argued that the Giftcards were gift certificates governed by the CPA. That statute broadly defines a gift certificate as “a written promise given in exchange for payment to provide the bearer, upon presentation, goods or services in a specified amount.” The state claimed that the fees charged by Simon, to the extent they diminished the total amount for which the Giftcard could be redeemed, as well as the fact that the Giftcards had an expiration date, violated the statute. Specifically, the state argued that under the CPA, gift certificates of \$100 or less could not have expiration dates.⁷ The statute also prohibits any “[d]ormancy fees, latency fees, or any other administrative fees or service charges that have the effect of reducing the total amount for which the holder may redeem a gift certificate.”⁸

SIMON SAYS

Simon argued that the provisions of the CPA were not applicable to it, as the seller of prepaid electronic stored value gift cards issued by a national bank or federal savings bank, because of federal preemption under the NBA and regulations issued by the Office of the Comptroller of the Currency (OCC), and by HOLA and regulations issued by the Office of Thrift Supervision (OTS).

In Simon's view, the national banking laws, combined with the broad supervisory authority over national banks and federal savings associations that Congress vested in the OTS and the OCC, were exclusive and served to “preempt conflicting state regulation with respect to all banking activities, including those of parties engaged in the business of banking in concert with national banks.” Thus, Simon asserted, any claims against it relating to the administrative charges and fees imposed by the banks were actionable exclusively under federal law, which law preempted related state law claims.

THE AGENCY ARGUMENT

In reply, New Hampshire claimed that because the Giftcards were

promoted and sold by Simon, as agent for the banks, the CPA was not preempted by federal banking laws and could properly be applied to the Giftcards. In other words, because the Giftcards were sold by Simon—a non-bank entity—the federal banking laws did not preempt the limitations the CPA would otherwise impose on the fee structure of the Giftcards. The state also argued that by employing Simon as a sales agent, the issuing banks removed themselves too far from the consumer/purchaser for principles of preemption to apply. Simply put, according to the State of New Hampshire, Simon was not a national bank, and the Giftcard was not a bank product.

Simon moved for summary judgment.

THE LAW ON PREEMPTION

In its decision, the court first observed that federal regulations authorize both U.S. Bank and MetaBank to issue stored value cards, such as the Giftcard.⁹ The court added that implicit in that grant of authority to issue stored value cards was the “incidental” power to establish the conditions under which those cards were issued and employed (including fee schedules and expiration dates) – subject, of course, to applicable federal (rather than state) consumer protection laws.¹⁰ Consequently, the court went on, state statutory or regulatory provisions that purported to limit fees that could be charged to the holder of a stored value card, or otherwise imposed restrictions on the contractual relationship between the cardholder and the issuing national bank or federal savings association, were preempted.

The court then addressed whether the state could enforce provisions of the CPA against Simon (rather than either of the issuing banks), or whether Simon, as issuing agent of those banks, was also protected from local regulation by principles of federal preemption.

The district court stated that the mere sale of the Giftcard by Simon did not compel the conclusion that it was not a bank product. National banks and federal savings associations are specifically authorized to use third parties to carry on the business of banking, the court explained.¹¹ And, moreover, national banks routinely establish relationships with non-

banking entities to market or distribute the national bank's products. The court noted that examples included:

- issuance of private label credit cards (e.g., department store credit cards);
- issuance of co-branded credit cards;
- use of mortgage brokers to solicit real estate loans;
- use of automobile dealers to solicit loans to finance motor vehicles; and
- use of third parties to solicit tax refund anticipation loans.

DISTINGUISHING *BLUMENTHAL*

The court then distinguished its case from a case relied on by the state, also involving Simon, *Blumenthal v. SPGGC, Inc.*¹² In that case, the New Hampshire court explained, the challenged monthly maintenance fees were charged by and retained by Simon, not the issuing bank. The *Blumenthal* court noted that the issuing bank did “not profit from the monthly maintenance fees. Rather [the bank] earns its profit on the card by way of the interchange fees from Visa on a per-transaction basis.”¹³ Thus, it was Simon (a non-banking entity) that was charging and profiting from fees imposed on holders of stored value cards that arguably violated state law. The New Hampshire district court noted that that was a critical factual difference from the case it was considering, in which the issuing banks levied the various fees (which were disclosed to the customer and formed part of his or her contract with the issuing bank) and established the expiration dates for the Giftcards.

The New Hampshire district court also noted that Simon's role as sales and marketing agent for both U.S. Bank and MetaBank was quite circumscribed, unlike in *Blumenthal*. Its involvement in the U.S. Bank Giftcard program was limited to marketing of the program; maintenance of an inventory of Giftcards; the sale and initial collection of funds from the consumer; activation and loading of the Giftcard; the physical trans-

fer of the Giftcard to the consumer, along with a copy of the agreement between the consumer and U.S. Bank; and the remission of collected funds to the bank.

In addition, the New Hampshire district court explained that unlike earlier Giftcard programs, Simon was not compensated through the collection of fees imposed on Giftcard holders—those sums were retained by the issuing banks. Instead, consistent with its role as sales agent, Simon was compensated through a sales-based commission. Moreover, the district court pointed out, Simon had no authority to alter the terms of the Giftcards, the associated fee schedule, the substantive terms of the disclosures provided to the purchaser, or the terms and conditions of the contractual relationship that arose between the consumer and the issuing bank. Those aspects of U.S. Bank's relationship with the consumer were governed by the contract between the bank and the consumer, and they were subject to federal banking laws and regulations, as well as the regulatory oversight of the OCC.

According to the district court, Simon's involvement in the MetaBank Giftcard program appeared to be even more limited than its role in the U.S. Bank program: Simon marketed the cards issued by MetaBank at its various malls and through its Web site. Like the U.S. Bank Giftcard program, the relationship between the consumer and MetaBank was governed by the contract between those parties. Simon lacked authority to alter the terms of that contractual relationship. Finally, the contractual relationship between MetaBank and the Giftcard consumer was overseen by federal regulators—in this case, the OTS—and was subject to federal banking laws and regulations.

The district court mentioned that it was not persuaded by the state's argument that application of the gift certificate provisions of the CPA against Simon would not frustrate the purpose of Congress, calling it "unrealistic." If the state were able to enforce provisions of its CPA against Simon, according to the court, one of two consequences would necessarily follow: either the banks would be required to stop all sales in New Hampshire of the Simon Visa stored value Giftcard, or the banks would have to alter the terms and conditions of the contractual relationship between themselves and purchasers of those Giftcards to comply

with local law. Given that the Giftcards were banking products issued by federally chartered and federally regulated banks, the court opined that the state could not force the banks to elect between those options.

The district court was convinced that overseeing the terms and conditions of the Simon Giftcard, as well as those of the contractual agreement between purchasers of the Giftcard and the issuing banks, were matters for federal regulators, not an individual state. If there were to be any restrictions on fees associated with the Giftcards, or limitations imposed on expiration dates, the court stated that they must come either from Congress or the federal agencies empowered by Congress to oversee national banks and federal savings associations.

Accordingly, because the relationship between the issuing banks and the Giftcard consumer was substantial, the terms of the relationship established by the issuing banks, and Simon's involvement in the marketing and sale of those Giftcards on behalf of the issuing banks did not alter or even attenuate that relationship, the district court held that the terms of the relationship between the Giftcard consumer and U.S. Bank and MetaBank (including the fee schedule and provisions regarding expiration dates) were governed by federal banking law. The district court decided that state law, to the extent it purported to regulate the terms or essential aspects of that relationship, was preempted.

CONCLUSION

This case was a significant victory for the banking industry. The district court of New Hampshire decided that because the contractual relationship arising out of the purchase of a Simon Visa Giftcard was between the issuing bank and the customer and because the bank (not Simon) set the fee schedule, as well as the terms and conditions governing the use, replacement, and expiration of the Giftcards, the Simon Visa Giftcards were national banking products governed by federal law. (It should be noted that the district court stated that if allegations of fraudulent conduct or unfair business practices on the part of Simon were made, such claims would probably not be preempted.) Although not all stored value gift cards issued through agents of banks will necessarily be preempted from state

regulation, this case provides important guidance on the parameters courts will look to when asked to evaluate preemption issues in the future.

NOTES

- 1 *See generally Bank of America v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002) (discussing the preemptive effect of the Home Owners' Loan Act and Office of Thrift Supervision regulations); *Wells Fargo Bank of Texas v. James*, 321 F.3d 488 (5th Cir. 2003) (discussing the preemptive effect of the National Bank Act and regulations of the Office of the Comptroller of the Currency; *see also* OTS Opinion Letter P-2006-3 (June 9, 2006) (discussing federal preemption of state gift card restrictions); 12 C.F.R. § 7.5002(c) (noting that "State laws that stand as an obstacle to the ability of national banks to exercise uniformly their Federally authorized powers through electronic means or facilities, are not applicable to national banks").
- 2 *Blumenthal v. SPGGC, Inc.*, 408 F. Supp. 2d 87, 93-94 (D.Conn. 2006) (citation omitted).
- 3 No. 04-cv-420-SM (D.N.H. Aug. 1, 2006).
- 4 12 U.S.C. § 1461, *et seq.*
- 5 12 U.S.C. § 21, *et seq.*
- 6 N.H. Rev. Stat. Ann. (RSA) Ch. 358-A.
- 7 RSA 358-A:2 XIII.
- 8 *Id.*
- 9 *See, e.g.*, 12 C.F.R. § 7.5002(a)(3) (authorizing national banks to offer "electronic stored value systems"); 12 C.F.R. § 555.200(a) (authorizing federal savings associations to use "electronic means or facilities to perform any function, or provide any product or service, as part of an authorized activity").
- 10 *See generally*, OCC 98-31, Guidance of Electronic Financial Services and Consumer Compliance, 1998 WL 460874 (July 30, 1998).
- 11 *See, e.g.*, 12 U.S.C. § 24 Seventh (authorizing national banks to use agents to conduct banking business); OTS Thrift Bulletin 82a (September, 2004) (discussing savings association's use of third parties to provide assistance in providing banking services). *See generally Franklin Nat'l Bank v. New York*, 347 U.S. 373 (1954).
- 12 *Blumenthal v. SPGGC, Inc.*, 408 F. Supp. 2d 87 (D.Conn. 2006).
- 13 *Id.* at 94.