Rewarding Compliance-Laws, Regulations, and Litigation Relevant to Complex Loyalty Programs

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Introduction

• Loyalty programs are **promotional**—generally offer points or credits that may be redeemed for merchandise, travel, etc.

• Loyalty programs are **hugely popular** and growing. A 2017 study by Accenture found that 77% of consumers participate in a retail loyalty program, up from 72% over the last year.

• Loyalty programs are **complex**—they may implicate multiple areas of law:
  – Contract
  – UDAP/Consumer Protection
  – Gift Cards, Stored Value/Coupons
  – Privacy and Data Security
  – Sweepstakes and Contests/Charitable Promotions
  – Unclaimed Property/Tax
  – Money Transmission
  – Human Rights/Americans with Disabilities Act
  – Fraud
  – Social Media/FTC Endorsements and Testimonials Rule
  – Antitrust
  – Franchise
  – Third Party Agreements
Drafting Terms & Conditions

• **The terms are a contract**: Important to have in place comprehensive terms and conditions, as the terms are a contract between the member and the company sponsoring the program.

• **Right to modify/termination clause**: The right to modify and/or terminate the terms and conditions is key. Courts are often deferential:
  – *Lagen v. United Continental Holdings, Inc.*, Case No. 14-1375 (7th Cir. 2014): Seventh Circuit upheld the airlines’ right to change or eliminate frequent flyer program benefits.
  – *Han v. United Continental Holdings, Inc.*, 762 F.3d 598 (7th Cir. 2014): Seventh Circuit held that term giving interpretive discretion to United meant plaintiff must prove interpretation was unreasonable as a matter of law, affirming trial court’s dismissal.
Notice of Changes

• What kind of notice is required when making changes to a loyalty program?
  • Program terms should have a notice provision that defines: (1) how notice of changes will be provided; (2) how much notice will be provided; and (3) how members will accept changes.
    – Many loyalty programs provide for little or no notice (0 to 60 days).
    – Stating “Company will provide notice of changes” without defining the method of notice (e.g., posting on website, email) is arguably too vague and may potentially give rise to liability.
    – Acceptance: Click to accept? Continued participation? Best practice may vary based on type of term (e.g., arbitration, reduction of value).
• Notice has become a key issue in recent litigation.
  – Be particularly careful if the effect of the change is to eliminate earned rewards.
• Follow your procedures!
Notice of Changes: Best Practices

• **Notice should be clear and concise**
  – Explain the change
  – When it takes effect

• **Change should not impact bookings made prior to the change date**

• **Timing of notice** (not specified by law):
  – Should not be too far out (consumers forget), or too close to the change date (not enough time)
  – Consider multiple notices – 60 days out, 30 days out, 14 days out, 7 days out
  – Notice provided directly (by email or mail), or posting online

• **Good idea to give advance notice of any change that:**
  – Impacts the value of the member’s points
  – Changes the member’s ability to earn or use points
  – Cancels/terminates the program
  – Converts the points to a different program
UDAP/Consumer Protection Laws

• Federal and state laws prohibit merchants from engaging in unfair and deceptive trade practices, e.g.,:
  – Promoting a loyalty program in a false and misleading manner.
  – Failing to disclose material terms clearly and conspicuously.
  – Failing to meet reasonable consumer expectations and assumptions.
    • Watch for conflicts between advertising and terms.
• Traditionally, courts examining loyalty program claims have relied on the program terms to dismiss lawsuits, giving little weight to consumer protection claims.
  – But see Gao v. JP Morgan Chase & Co., Case No. 1:14-cv-4281 (S.D.N.Y. Sept. 12, 2017): Chase settled case alleging that its promise “points never expire” was deceptive.
• Several state attorneys general have filed cases against large drugstore chains alleging that their programs were deceptive.
Earnings and Redemption

• Earnings and redemption are crucial considerations: How you calculate the value of rewards points can land your business in hot water!

• If loyalty points generate discounts at checkout, then they must be applied consistently and in conformity with program terms and advertising—this has been a source of litigation.
  – If purchases generate loyalty points, customers must receive the full amount promised by the terms of the program.
  – Companies must apply discounts as promised, disclose any exceptions, and follow loyalty program requirements.

• Customers will know when they are shortchanged! E.g.,
  – **Waters v. Kohl’s Department Stores**, Case No. 2:17-cv-02325 (C.D. Cal. 2017). Kohl’s Dept. Stores sued for deducting “Kohl’s Cash” from a purchase before other discounts applied; plaintiffs allege store violated its promise that the points would be treated the same as cash.
Gift Cards and Stored Value/Coupons

• Loyalty programs often allow consumers to accumulate/redeem credits, codes, vouchers, or cards that are similar to a gift card or stored value card.

• Some ambiguity over whether loyalty points/certificates are actually “gift cards.” *Cortney Reynolds v. Phillip Morris* (9th Cir. 2009): NO.

• The CARD Act and similar state laws restrict expiration dates or fees and require disclosure of material terms.

• If cards offered as awards under loyalty programs expire, are they legal?
  - Answer is generally yes.
  - Section 401 of the CARD Act and similar state laws typically either: (a) expressly exclude cards awarded pursuant to “loyalty, rewards, or promotional programs” provided that certain disclosures are made; OR (b) exempt/exclude gift cards for which no cash/consideration is paid.

• Required card disclosures:
  - Front must state card is “promotional,” “rewards,” “loyalty” card;
  - Expiration date must be included on front in no less than 10-point font;
  - Additional requirements if fees charged, e.g., 1-800 number or website must be provided.
State unclaimed property laws, rooted in the common law “escheat,” provide that property may be presumed abandoned if there is no activity for a specified dormancy period.

State regulators have been increasingly aggressive in seeking to collect.

- A few attorneys general (including Delaware) have tried to include such property in settlement negotiations and audits.


Not necessarily clear whether loyalty program points, credits, accrued discounts, etc., will be treated as subject to the unclaimed property laws.

- “Derivative rights” doctrine suggests state shouldn’t have right.
- There has yet to be a publicly announced settlement that has included loyalty program funds/property within its scope.
Tax

• S&H Green Stamps Rule
• 26 C.F.R. 1.451-4 and the Accrual Method: Allows accrual-method taxpayers to subtract from gross receipts an amount equal to
  – The cost of redemptions in the tax year and
  – Estimated future redemptions.
    • Therefore allows an accelerated recognition of redemption costs.
• Must meet certain requirements.
  – “With sales” requirement – points awarded when making a purchase.
  – “Redeemable” requirement – points must be redeemable for cash, merchandise, or other property.
• Most retailer customer loyalty programs qualify under the regulation ... but not all. (Rev. Rul. 78-212)
Sweepstakes and Auctions

• Increasingly common to link sweepstakes and auctions to loyalty programs as a way to win or redeem points.

• **Possible lottery/gambling issue**: If rewards points are required to buy entries or bid, is that consideration? Do you need to offer a free Alternative Method of Entry (AMOE)?

• Do points even have value?
  • Points are often treated as being without value for tax and other purposes.
  • What if you can redeem points for gift cards with cash value?
  • What if you have a “buy it now” bid price for items being offered?

• Auctions: if the members lose the points they have bid (or some minimum number) regardless of whether they win the item, it may potentially be gambling.

• **Best practice is simply to offer a way to participate for free (free AMOE) to ensure there is no consideration issue.**
Money Transmission/AML

• Bank Secrecy Act/anti-money laundering laws: Define money transmission as receipt and/or transmission of currency/funds or their value to another person or location.
  – A “currency” for purposes of money transmission includes “convertible virtual currencies” that have an equivalent value in real currency or that serve as a replacement for real currency.

• Consider:
  – Can points be purchased or redeemed for cash?
  – Is there a secondary market for points or credits?
  – Can members transfer points or credits to each other?

• If the answer to any of these questions is yes, there is a risk that money transmission laws may apply.

• Unclaimed property laws have started to include provisions addressing virtual currency as well, e.g., Utah, Delaware bills.
Charitable Promotions/Commercial Coventions

• Many programs now offering the ability to donate points to charitable partners. What are the legal and practical issues?
  – Commercial coventions (CCVs) with charities may trigger registration and bonding requirements, along with specific advertising, accounting, and agreement requirements.
  – If there is no “purchase” (“free action”), then the CCV laws may not be triggered.
  – Are specific charities identified? Or can customers choose their own charity?
    • Is the charity registered to conduct fundraising?
    • Has an agreement been negotiated with the charity that includes a trademark license?
    • Have specific donation triggers/dates been set? What if they are not met? What if they are exceeded? Will an accounting be provided, and when?
Privacy and Data Security

• Loyalty programs are often used to collect personal information from participants.
• Federal and state laws regulate how businesses collect, store, use, or disclose personal information from consumers (especially sensitive information such as financial information, information about purchases, etc.)
• Certain laws may specifically regulate collection of information in conjunction with loyalty programs:
  – Illinois law prohibits disclosing identity or purchases of shopper’s club discount club members without consent. See Ill. Comp. Stat. 505/2JJ.
  – In California, the Supermarket Club Card Disclosure Act of 1999, Cal. Civil Code Sec. 1749.60-1749.66, prohibits supermarket club card issuers (1) from requesting driver's license numbers or Social Security numbers, and (2) from selling or sharing personal customer information. There is, however, a limited exemption for membership card stores, such as Costco and Sam's Club.
• What is being disclosed in your privacy terms? Are you aggregating sales and marketing data?
Is your loyalty program accessible to individuals with disabilities?

– Title III of the Americans with Disabilities Act (ADA) prohibits discrimination on the basis of disability in places of public accommodation.

– Courts are split as to (1) whether the ADA applies to websites; and (2) the degree to which it applies/under what circumstances.

  • Does the ADA apply only to websites that have a physical connection to goods and services available at a physical store or location?

  • **Gil v. Winn-Dixie Stores (2017):** First trial verdict in an ADA website-accessibility case (Winn-Dixie required to make accessible).


  • Other challenges include discrimination on basis of gender, age, etc.
Fraud

• **Fraud can be a big problem with loyalty programs:**
  – Consumer fraud—owner of account violates terms of service to illegitimately accumulate points
  – Internal fraud—employees and insiders
  – External fraud—hacking, identity theft

• **How to limit risk?**
  – **Robust and clear rules:** Carefully craft rules to prevent unintended point schemes, detect illegitimate uses, and preserve right to fully enforce all program rules.
  – **Educate program members:** Incentivize members to use strong passwords, periodically change their passwords, and monitor their account activity.
  – **Intrusion protection** Implement industry standard cybersecurity protocols and intrusion detection to prevent and alert the system manager of any breaches.
  – **Enhanced internal controls and monitoring:** Includes enhanced vetting of program administrators and employees, restricting access of internal controls to a “need-to-access” basis, and monitoring the system for irregularities.
Social Media and the FTC’s Endorsements and Testimonials Rule

• Basic principles:
  – **Material connections** that might affect credibility must be disclosed, e.g., payment or other compensation; employment, business, or family connections.
  
  • “**Other compensation**” may include loyalty points.

• Includes social media influencers/bloggers, who have been the subject of significant enforcement in this area.

• **Facebook Advertising Guidelines**: Cannot incentivize sharing through use of loyalty points, sweepstakes entries, etc.
CAN-SPAM

- Incentivizing referral emails (e.g., with additional rewards points) may trigger CAN-SPAM requirements.
- Establishes standards for sending of commercial email:
  - Don’t use false or misleading header information.
  - Don’t use deceptive subject lines.
  - Include your valid physical postal address.
  - Provide an opt-out mechanism.
- Must scrub referrals against internal “do-not-email” list.
- Must take into account platform TOS: e.g., incentivized programs may also violate Facebook platform rules.
Antitrust

• Offering a richer promotional program to one retailer over another could be discriminatory.

• Offering rewards programs to the employees of customers as part of trade promotion may trigger commercial bribery issues under Robinson-Patman Act, 15 U.S.C. § 13(c), and similar state laws – get employer consent.


• One recent case alleges that a paint finishing supplier used its loyalty program to provide discounts that unreasonably restrained trade.
Franchise

• Can you force franchisees to participate in a loyalty program?
  – Some jurisdictions prohibit in certain industries.
    • See, e.g., D.C. Code § 36-303.01 (retail service stations).
    – Rather than requiring participation, consider incentivizing it.

• Wyndham/Choice lawsuits (2011): Lawsuit filed by franchisees against Wyndham and Choice alleging hotel brands auto-enrolled guests who booked online into loyalty programs unless guests opted out.
  – Franchisees were required to pay loyalty program fees of up to 5 percent of gross room sales generated by program – though guests might not know they are entitled to loyalty benefits.
  – Franchisees claimed that charging the extra fee violated contracts and FL DUTPA, seeking >$260M in Wyndham and >$225M in Choice.

• Franchisors should explicitly reserve right to change terms of franchise agreement; a general provision permitting franchisor to change “systems standards” or “rules of operation” may not be sufficient.

• Oversight and supervision is important to ensure that advertising by franchisees is consistent with official terms and conditions.
Third Party Agreements

• Many third parties may be involved in executing a loyalty program.
• Important to be clear about roles/requirements/dates/etc, but also to pay attention to legal compliance requirements.
  – E.g., who is responsible for registering sweepstakes? What are requirements regarding privacy/data security responsibilities
  – Get representations and warranties about compliance
  – Indemnification is nice, but get it backed up by insurance
  – Substantial assistance doctrine: all parties may be liable for consumer protection violations.
AND NOW FOR A WORD FROM OUR PANELISTS!
Questions?
Thank You

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