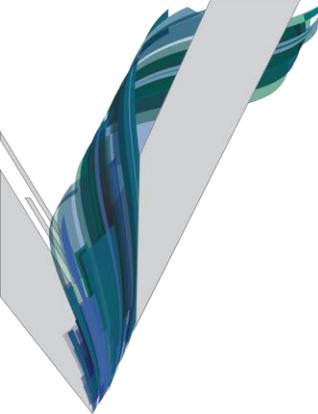




Rewarding Compliance-Laws, Regulations, and Litigation Relevant to Complex Loyalty Programs

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Speakers



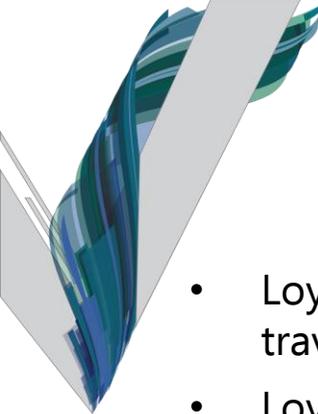
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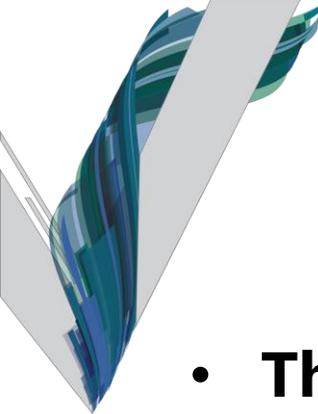


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Introduction

- 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



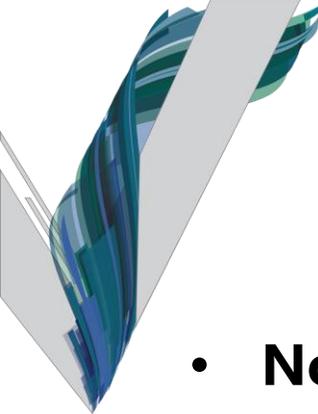
Drafting Terms & Conditions

- **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.
 - *Monzingo v. Alaska Air Grp., Inc.*, 112 P.3d 655 (Alaska 2005); *Grossman v. USAir, Inc.*, 33 Phila. Co. Rptr. 427 (Ct. Com. Pl. 1997): Airlines allowed to increase number of miles required for rewards where there was clear reservation of rights in program terms.



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.
 - *See, e.g., Hughes v. AutoZone Parts Inc.*, Case No. BC631080 (Sup. Ct. Cal., August 18, 2016).
 - Be particularly careful if the effect of the change is to eliminate earned rewards.
- Follow your procedures!



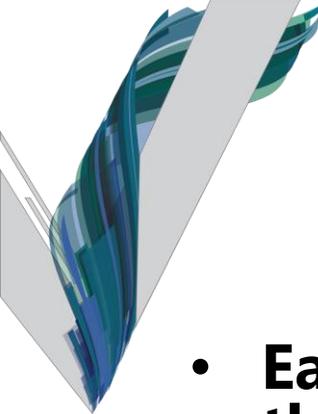
Notice of Changes: Best Practices

- **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.
 - *See, e.g.*, **NY Attorney General Settlement with Walgreens/Duane Reade** (2016); **Missouri Attorney General Lawsuit against Walgreens** (2013); **Florida AG settlement with CVS** (2007).



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.,
 - ***Neil Torczyner v. Staples Inc.***, Case No. 3:16-cv-02965 (S.D. Cal. 2016)
 - ***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.



Unclaimed Property

- 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.
 - ***State of Delaware ex. rel. William Sean French v. Overstock.com, Inc.*** (C.A. No. N13C-06-289 Del. Sup. Ct. 2018). Overstock.com found guilty in reverse False Claims Act case for concealing ~\$3 million from escheat.
- 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.
 - At least one state, Arizona, specifically exempts “merchandise points” from escheat. Ariz. Rev. Stat. § 44-301(15).



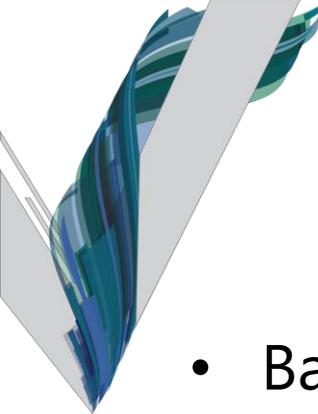
Tax

- 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](#))



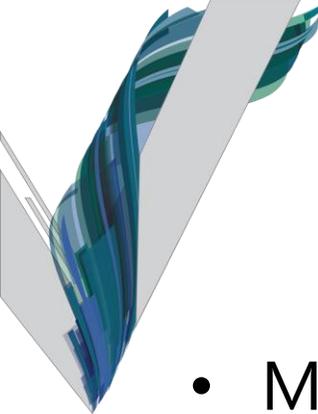
Sweepstakes and Auctions

- 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 Coventures

- Many programs now offering the ability to donate points to charitable partners. What are the legal and practical issues?
 - Commercial coventures (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?



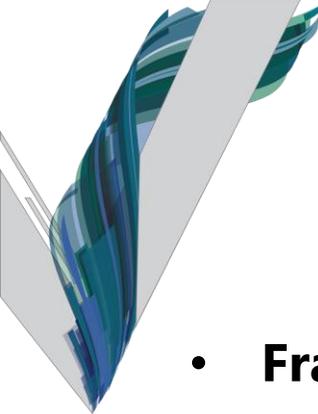
Privacy and Data Security

- 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?



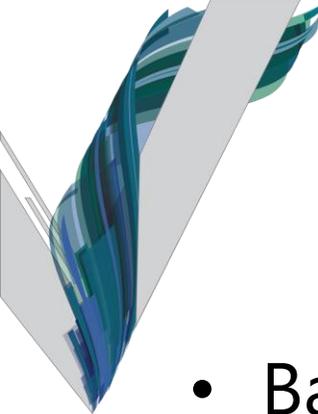
Human Rights/Americans with Disabilities Act

- 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).
- ***Nat'l Fed'n of the Blind v. The Container Store, Inc. (D. Mass. Aug. 25, 2016)***: Plaintiff sued Container Store alleging The Container Store's loyalty program discriminates against the blind because the in-store electronic devices on which customers could enroll cannot be independently used by blind customers. On appeal to 1st Circuit.
- Other challenges include discrimination on basis of gender, age, etc.



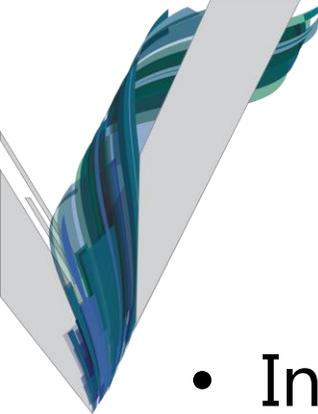
Fraud

- **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.



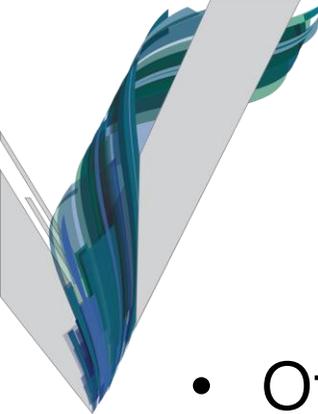
Social Media and the FTC's Endorsements and Testimonials Rule

- 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.



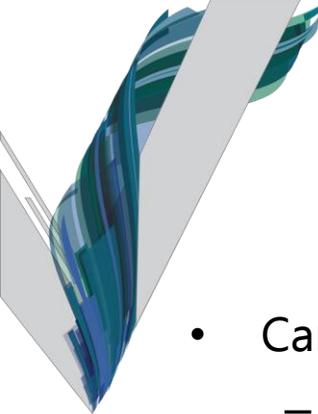
CAN-SPAM

- 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.



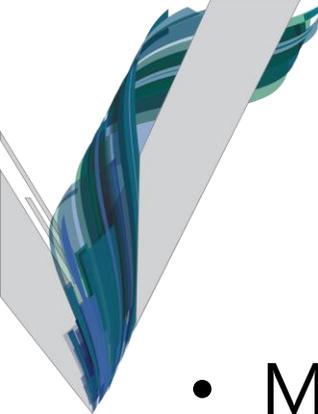
Antitrust

- 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.
- ***Nicolosi Distributing, Inc. v. FinishMaster, Inc.***, Case No. 5:18-cv-03587 (N.D. Cal. Comp. Filed June 15, 2018).
- 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.

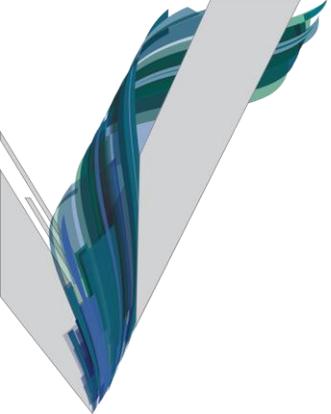


Third Party Agreements

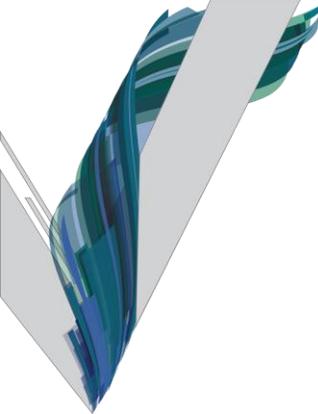
- Many third parties may be involved in executing a loyalty program.
- Important to be clear about roles/requirements/dates/etc, but also to pay attention to legal compliance requirements.
 - E.g., who is responsible for registering sweepstakes? What are requirements regarding privacy/data security responsibilities
 - 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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