

PUBLICATION

Spotlight on Unclaimed Property: CFPB Rules That Federal Law Preempts Tennessee's Unclaimed Property Statute Applicable to Gift Cards

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In its first preemption determination, on April 19, 2013, the Consumer Financial Protection Bureau (CFPB) ruled that Tennessee's unclaimed property statute provisions applicable to gift cards are preempted by federal law. The CFPB - the federal agency with primary responsibility for regulating consumer protection with regard to financial products and services - was established as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, with the CFPB's first director appointed in January 2012.

Background

Federal law generally prohibits the sale of a gift card that expires sooner than five years after the date when funds were last loaded onto the card. Under the 1978 federal Electronic Funds Transfer Act (EFTA), as amended by the Credit Card Accountability and Responsibility and Disclosure Act of 2009 (CARD Act), the CFPB is empowered to make preemption determinations on its own motion, or upon the request of any state, financial institution or other interested party, as to whether state laws "relating to" gift cards, among other things, should be preempted by the EFTA and CARD Act.

States' unclaimed property laws provide specific periods of time after which particular categories of unclaimed property are deemed "abandoned" and custody of such property must be transferred from the entity holding the property (holder) to the states. The owner of the gift card must then make claim to the amount of the gift card with the state by following that state's unclaimed property claims procedures.

Tennessee's Consumer Protection Act excludes from the term "gift certificate," prepaid cards usable at multiple, unaffiliated merchants or automated teller machines (so-called "open loop" gift cards). However, traditional gift cards, gift certificates, and "closed-loop" stored value cards are one category of property that is subject to Tennessee's unclaimed property statute.

It is common for gift cards to have unredeemed balances or "breakage." Under Tennessee law, the "breakage" is presumed abandoned if it remains unclaimed (i.e., unredeemed) by the owner upon the earlier of (a) the expiration date of the card, or (b) two years from the date the gift card was issued. A gift card is not subject to Tennessee's unclaimed property statute if no dormancy charge is imposed, and the gift card conspicuously states it does not expire, bears no expiration date or states that any expiration date does not apply in Tennessee. If a gift card becomes presumed abandoned, the issuer may elect to honor the card (and seek reimbursement from Tennessee), but is not required to honor a gift card that has been transferred to the state as unclaimed property.

Preemption Determination

Because a holder is not required by statute to honor a gift card that has become presumed abandoned under Tennessee law (unlike a Maine statute that was determined to not be preempted) and Tennessee's dormancy period was only two years, the CFPB ruled that the Tennessee statute was preempted by federal law. In essence, the state law had the effect of permitting gift cards to expire sooner than the five years permitted by the EFTA and CARD Act.

The CFPB was also not persuaded that the Tennessee claim procedures provided adequate protections to consumers, or that Tennessee law is more protective of consumers than federal law.

Nonetheless, the CFPB's determination was limited to the extent that holders of gift cards presumed abandoned were not required by Tennessee law to honor such gift cards upon presentment by a consumer.

Conclusion

While the CFPB determination is a welcome decision for holders of presumed abandoned gift cards reportable to Tennessee, it does raise a host of issues and considerations for holders. For example, it is unclear how the Tennessee Unclaimed Property Division will respond. The CFPB's determination has a parallel to the U.S. Department of Labor's determinations that state unclaimed property laws affecting employee benefit plans were preempted by ERISA. Some states refused to comply (and prevailed in some federal and state courts). While more recent federal court decisions have been in favor of preemption, holders were in the middle of a conflict of federal and state laws. Depending on the Unclaimed Property Division's reaction, holders of unredeemed gift card balances could find themselves in a similar position.

In the meantime, holders will need to evaluate the Division's potential responses in terms of their reporting. Such an evaluation may need to consider whether to report presumed abandoned gift card balances to Tennessee or defer reporting until the federally permitted five-year expiration period is satisfied. A holder will also need to consider how the CFPB's determination and its reporting decision affects its accounting for the breakage as a deferred revenue liability on its balance sheet. In addition, and especially for holders operating in multiple states, Tennessee's statute is similar to the statutes of other states and those states' unclaimed property laws applicable to gift cards may be similarly preempted.

These and other issues will need to be addressed by holders, and hopefully the Unclaimed Property Division will issue needed guidance. If you would like to discuss the CFPB's preemption determination regarding the Tennessee unclaimed property statute or state unclaimed property laws applicable to gift cards in general, please contact one of the attorneys in the Firm's Tax Department.