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Playing Your Cards Right

Peter Bowal

A recent survey in the lead-up to the last Christmas season showed that almost three-quarters of Canadians planned to buy gift cards and gift certificates for their friends and family. Despite far fewer folks actually wanting them as gifts (about 12%), it is clear that gift cards are a major marketing and consumer trend.

One of the fastest growing products in the marketplace today, 82% of large retailers made gift cards available in 2005 compared to 53% in 2003 according to Statistics Canada. The study found that stores that introduced the gift cards in 2003 had sales that averaged $11.8 million per store in 2005. This was more than twice the average of $5.0 million among the group that had not offered gift cards at that time. The gift card is the fastest growing retail product in North America and worth roughly $80 billion[1] annually to retailers.

A prepaid card is a plastic card with either a magnetic stripe or an embedded chip that resembles a credit card but is *prepaid*. Despite looking like a credit card, it does not involve credit. The purchaser pays in advance to have a certain amount of money *loaded*

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or assigned to the card. The card can then only be used up to the amount that has been loaded onto the card. The cards have become popular with young people and persons unable to obtain credit.

A gift card is pre-loaded with a specific value which can be used to purchase goods or services until that value is consumed. These cards are marketed as *the closest thing to cash*, but, unlike real cash, gift cards expire at some point in the future or have their value reduced by the issuer levying a monthly maintenance fee. The monthly fee would eventually consume the entire value of the card.

This article describes the retailer and consumer stakes in this phenomenon, current and proposed legislation, and how existing consumer protection can be applied to gift card expiry dates or fees.

The Retailer Interests

Gift cards are easy to stock, reduce inventory burden, and allow for easy up-sell/cross-sell. The gift card increases customer loyalty and "upspending" which is the reality that most customers will top up their gift cards with additional purchases. Statistics Canada found that stores issuing gift cards had more than twice the number of sales as stores that did not offer them.

Merchants say that they levy administrative fees and impose expiry dates on these cards because these cards create a liability that must be accounted for on the balance sheet. Typically, prepaid gift cards are recorded as prepaid sales liability. Unless gift cards are redeemed, revenue is not recognized because the prepaid sales liability remains on the books. Managing old cards without expiry dates requires records to be kept indefinitely. Since the value of the card is stored electronically, usually through a third-party provider, the management and storage of card status will entail various costs on the part of the retailer. If a small number of cards go unused, the retailer must manage all cards some of which will have very little stored value. Would the retailer have to manage them forever using archival and retrieval systems? Earlier paper-based gift certificates bore no ongoing management costs after issue.

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The data on these servicing costs is not clear, although there is some reference to costs in the 5th Session of the 38th Legislature of the Legislative Assembly of Manitoba (Standing Policy Committee on Social and Economic Development, 2006). According to the Retail Council of Canada, many gift cards have expiry dates because buying a card is like purchasing an account with the store: "that's a product that needs to be maintained and serviced on a regular basis by the retailer, and there's a cost to doing that," said Derek Nighbor, the Council's Vice-President of National Affairs.[2]

For merchants, the gift cards are superior to their paper counterparts since they do not require paper-based settlement, which makes their transactions easier to clear and settle. Gift cards enable merchants to gather data about consumers' use of the cards which provides important marketing information about consumer purchasing behaviour. Gift cards may also be re-loadable, and they can store the value remaining after each use, freeing retailers from having to provide change after purchase.

The Consumer Interests

The gift card allows the donor to make a statement about what general category of gift was intended without committing to a specific gift purchase that might incur taste, fit, and preference issues, and returns. It is easy to purchase a credit at a particular merchant and leave the timing and detail of use of that credit with the person receiving the gift. This appears to be a middle ground between buying a specific gift and giving money.

Gift cards attract consumers because of the convenience and simplicity to the donor and the choice and control of the recipient. The giver can purchase gift cards from anywhere. Gift cards have virtually turned gas stations and grocery stores into a one-stop shop where a person can pick up gift cards for restaurants, clothing stores, music stores, and more. Gift cards are also easy to wrap, send, and are slightly more creative than giving cash. For the recipient, the prepaid gift card allows for choice to select what one wants and when one wants it.

This modern card, similar to the standard credit card that we have become so accustomed to using, is not easily damaged and conveniently fits into our wallets. It makes an ideal gift. Many can be purchased using points from loyalty or rewards programs. Some gift card programs offer additional benefits such as a bonus amount if purchased before a certain date.

Expiry dates and other fees are typically not clearly identified on the cards and are not explained to the consumer at the time of purchase. In any event, the purchaser of

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the gift card is rarely the ultimate user of it. This means that even though the cards are sold as an *as good as cash* replacement, and consumers give merchants money to effectively hold in trust till a later date, they may end up not being able to redeem these cards or recover their initial expenditure or goods of equivalent value.

Breakage

Many gift cards come with terms and conditions such as invalidity on the date of purchase, change will not be given, and the cards must be redeemed by a certain date. Retailers like selling gift cards because they draw immediate loyalty and cash for services of merchandise that will be delivered in the future or never. Eighty percent of gift cards have expiry dates within 24 months of purchase. Retail industry surveys show that approximately 10% of the money stored on gift cards is never used. This value on prepaid gift cards never used to redeem for merchandise is referred to as *breakage*. In North America, this amounts to an annual windfall of between $4 and $7 billion.

According to a chapter in the book, *Freakonomics*, entitled "The Gift-Card Economy", retailers recognize two substantial benefits with gift cards: breakage and upspending. While consumers benefit from the convenience of gift cards, they do not benefit from expiry dates and fees for using them. Retailers profit from the neglect of the customer to use the card. Customers might forget, lose, or misplace the card; they might be too busy or otherwise pre-occupied to visit the store; or they might prefer to delay use. *As good as cash* converts to a contingent financial liability for the customer and a corresponding windfall for the retailer while real cash itself does not expire.

Delaying use of the prepaid gift card carries a penalty in terms of inflationary prices. The value of the card, in real terms, decreases as the costs of goods and services increase over time. The same is true for cash not covered by an interest-bearing account.

Legislation

Due to increasing consumer complaints, these fees and expiration dates have become a concern for lawmakers. Existing general consumer protection legislation may be adequate in some provinces to address the problem. For example, the Alberta *Fair Trading Act* contains several provisions that could be applied to gift cards, their expiration, and fees.

As a matter of legal policy, this is a product that warrants legislative intervention to protect the consumer interest. The economic stakes of the prepaid gift card industry are significant and growing.

Section 6(4) (a) of the Alberta legislation stipulates that it is an unfair practice for suppliers to do or say anything that might reasonably deceive or mislead a consumer. Merchants must be forthcoming with consumers at the time of purchase about any limitations on the cards, such as expiry dates and any other fees or charges that do not render these cards *as good as cash*. Section 7(3) entitles consumers to recover the fees or expired losses if the conduct of the merchant was an unfair practice. The gift card scenario is complicated because the purchaser of the gift card is rarely the ultimate consumer of it. The consumer was not a party to the purchase transaction. On the other hand, class actions may also be available to seek redress of bad gift card practices.

At least three provinces are in the process of putting in or have put in legislation that governs or controls some aspect of this industry. In late 2006, the Ontario government enacted the *Consumer Protection and Service Modernization Act* which, among other things, allows the province to ban expiry dates on consumer gift cards. The amendment added "future performance agreements including gift card agreements," so that subsection 123(5) restricts businesses from imposing fees and restrictions on prepaid cards.

Manitoba has also implemented very similar legislation under Bill 4 relating to the *Consumer Protection Act* (ss. 170-173). Similarly, the Nova Scotia government introduced legislation to ban expiry dates on gift cards and certificates.

A jurisdictional issue may arise in Canada. If retailers in Ontario, Nova Scotia, or other provinces with expiry date legislation issue their cards as Visa or MasterCard (i.e., bank-issued) gift cards, the provincial legislation may not apply. In such a case, the retailer would simply be acting as the agent in the sale of the gift cards — it would not be the issuer. The retailer in such a case would likely not receive the proceeds from unused gift card balances but would more likely receive a simple commission from the issuing bank at the time the card is sold.

The precise definition of these regulated cards also poses a problem for regulation. Some products in the 1990s, including Mondex and Visa Cash, were perceived by some to be new forms of money. Like today's gift cards, they were denominated in Canadian dollars, offered the same transactional anonymity as cash, and were similarly liquid (although required to be used at specific retailers).

If gift cards are considered to be money, their use would likely be regulated, if at all, by the federal government as custodians of the Bank of Canada and the currency supply. Provincial regulation of gift cards may be constitutionally constrained. However, the legal characterization of gift cards as real *money* contrasts with Canadian Tire money. This company's *money*, introduced in 1958, has some features of real money in that it does not give access to a deposit account or line of credit (like a credit card or debit card), it is transferable by delivery, it may be sold or given to third persons, and it may be redeemed by anyone. It is not considered true legal money since the notes are redeemable only by the one issuing merchant and its associated franchisees.

While gift cards are a relatively new product, the old law of *escheats* may prevent retailers from expiring them. Many jurisdictions have unclaimed property rules — *escheat* laws — which give governments a legal claim on unspent and unclaimed money. If the government has a legal right to the proceeds from unspent gift card balances, retailers may not be able to *claw back* this amount through the use of maintenance fees or expiry dates. This may protect the estates of deceased gift card holders. It may not be possible for retailers to claim part of this estate through the imposition of maintenance fees or by expiring cards.

Other solutions may also exist to protect the interests of both the consumer and the retailer. For instance, after a period of inactivity, the user may be required to convert the stored balance into a paper-based voucher, so that the retailer can avoid having to manage the account indefinitely. As well, new methods and techniques of restoring expired amounts may similarly allow retailers to archive old account balances rather than having to maintain them on transactional systems.

In the United States, at least half of the states have passed laws concerning gift card fees or expiration dates. Banks have been ordered to avoid making misleading claims such as stating that a card has *no expiration date* when it has a monthly maintenance fee which will eventually deplete the card. Up until recently, only three of the top 40 merchant gift cards had expiry dates.

Conclusion

In the 2006 British Columbia Supreme Court case of *MacLean v. Telus Corp.,* the purchasers of prepaid cellular phone cards received notice from the company that the prepaid credit would expire. After the notice period ended, the company cancelled all unused prepaid credit. The plaintiffs brought a class action against the company for breach of contract. This case was not certified as a class proceeding because the proposed class members did not share a common contract (the contracts were partially oral and partially written). It is an example of consumers' frustration with expiry dates on prepaid items.

As a matter of legal policy, this is a product that warrants legislative intervention to protect the consumer interest. The economic stakes of the prepaid gift card industry are significant and growing. At the point of sale, there is a likelihood of mischief in the understatement of fees and the expiry of cards. The cards are knowingly sold to customers who likely will not be using them ultimately, and the wide representation that they are *as good as cash* is apt to be misleading in the circumstances. Both purchaser and consumer of the cards are not having their reasonable expectations met in these prepaid cards. The inherent third party consumer problem may lead to greater breakage rates as the recipients of these gift cards feel powerless to complain to the merchant or the donor. Any offsetting administrative costs of these cards can be best shifted to the merchants who benefit from the measurable loyalty effects of the cards.

If gift card recipients do not have protections under general consumer protection legislation, we suggest that such legislation be amended to prohibit expiry dates, and service and dormancy fees on prepaid gift cards. At the minimum, these restrictions should be required to be printed prominently on the front of the prepaid cards. The prepaid card industry would continue to grow and consumer interests would be protected.

Peter Bowal is a Professor of Law with the Haskayne School of Business, University of Calgary. *With thanks to Kimberly Bowal for her assistance in preparing this article.*

Notes

1. "The Gift Card Economy", in *Freakonomics*, Stephen J. Dubner and Steven D. Levitt, January 2007
2. Manitoba Wants Gift Cards That Stand Test Of Time. *CBC News*, September 26, 2006